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PRESIDENT'S PROPOSED REVENUE INCREASES

HEARING

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

FEBRUARY 4, 1987

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PRESIDENT'S PROPOSED REVENUE INCREASES

WEDNESDAY, FEBRUARY 4, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The Committee met, pursuant to notice, at 10:22 a.m., in Room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen, Chairman, presiding.

Present: Senators Bentsen, Baucus, Bradley, Mitchell, Rockefeller, Danforth, Chafee, Heinz, and Durenberger.

[The press release announcing the hearing, the prepared statements of Senators Bentsen, Mitchell, Rockefeller, Heinz, and Durenberger and a summary of Revenue Provisions in the President's FY 1988 Budget Proposal follow:]

[Press Release No. H-4, Jan. 15, 1987]

SENATOR BENTSEN ANNOUNCES HEARINGS ON ADMINISTRATION TAX PROPOSALS

WASHINGTON, DC.—Senator Lloyd Bentsen, Chairman, announced Thursday that the Senate Finance Committee will hold a hearing on revenue increases proposed in the President's Budget.

"The President's Budget includes $22.4 billion of tax increases and other revenue increases for fiscal year 1988. The Finance Committee has jurisdiction over about $6 billion," Bentsen said.

"We want to explore whether the President's tax proposals are the best method of achieving our budget goals."

The hearing will be held on Wednesday, February 4, 1987, beginning at 10:00 a.m. in Room SD-215 of the Dirksen Senate Office Building. The President's proposals which will be covered by the hearing include:

(1) Extension of the Medicare part of the Social Security tax to all state and local employees;

(2) Expansion of the employer share of Social Security to include all cash tips;

(3) Extension of Social Security to inactive duty earnings of Armed Forces reservists and to "certain" students, agricultural workers, children aged 18-21 who work for their parents, and spouses who work for their spouses;

(4) Treatment of employer-provided group life insurance as taxable income for purposes of the Social Security tax;

(5) Repeal of current law exemptions from the gasoline, diesel fuel and other highway excise taxes;

(6) Increases in the coal excise tax and treatment of black lung income replacement benefits as taxable income;

(7) Increases in the railroad retirement payroll tax and extension of the Federal unemployment tax to railroad employment;

(8) Repeal of the Windfall Profit Tax;

(9) Repeal of the customs user fee exemption for imports with American made components and extension of the fee;

(10) Increases in Pension Benefit Guaranty Corporation premiums for employers;

(11) Extension of the excise taxes that finance the Airport and Airway Trust Fund;

(12) Imposition of user fees for the Bureau of Alcohol, Tobacco, and Firearms; and

(13) Increases in Internal Revenue Service funding.

The hearing will *not* cover the President's spending reduction proposals that are within the Committee's jurisdiction.

STATEMENT BY SENATOR LLOYD BENTSEN

This is the first in a long series of hearings and meetings on the budget process for fiscal year 1988.

The Administration maintains that the budget they sent to us meets the Gramm-Rudman-Hollings deficit target of $108 billion, with receipts of $916.8 billion and $1.02 trillion in outlays. The budget includes $22.4 billion in tax and other revenue increases and calls on this committee to increase taxes by over $6 billion.

According to preliminary estimates by the Congressional Budget Office, the Administration budget does not meet the deficit target for fiscal 1988. Instead of the mandated $108 billion, CBO estimates the budget includes a deficit of between $135 billion and $140 billion.

So even if Congress were to accept all the Administration's proposals for spending cuts and tax increases—which is not likely—we would still need to find an additional $27 billion to $32 billion in order to meet the target.

I would take this opportunity to ask the Administration to work with us in good faith to meet the deficit reduction goals of Gramm-Rudman-Hollings. Without active cooperation between the Administration and Congress, we won't get the job done.

I also think it doesn't get us very far to say that the proposals in the budget are not tax increases—which would be bad—but revenue increases—which are acceptable. The President recently told us that his proposed budget "cuts spending and leaves your family's paycheck alone."

I am sure that many Americans would disagree with that statement—for example, the state employee in Alaska or the teacher in Texas who would be required to contribute part of his or her wages to Medicare for the first time. Their paychecks would not be left alone. The same holds true for the coal mine operator who would face an increased bill for coal excise taxes; the state and local governments which would pay fuel excise taxes for the first time; and the list goes on.

I am not saying that the Administration's proposals should not be enacted, only that to the people affected, they are taxes.

Turning to today's hearing, our primary purpose is to find out exactly what the Administration proposes. We have a variety of odds and ends that have not been fully fleshed out in the budget documents. We will hear from Administration witnesses today and will schedule public witnesses at a later time.

STATEMENT OF SENATOR GEORGE J. MITCHELL

It is indeed unfortunate, but all indications are that the budget process will once again break down this year without any real progress being made against the enormous budget deficits that threaten the American economy.

As in the past, the Administration is refusing to deal forthright with the federal budget deficit and the question of federal revenues. According to the Congressional Budget office, the Administration's budget is at least $27 billion short of the savings that are necessary to meet the deficit targets for Fiscal Year 1988. Even if Congress were to accept every proposal in the Administration's budget, we would need to make another $27 billion in spending cuts. Spending cuts, not revenue increases, because other than that which is already in the Administration's budget, revenues are off limits according to the President.

The President's budget depends for most of its deficit reduction on new revenues—$22 billion of the $42 billion in deficit savings.

Of that amount, fully $12 billion in new revenues are proposed to be raised through the sale of government assets. Whatever the policy merits of selling government assets, this has nothing whatsoever to do with long term deficit reduction. It is a cynical means of reaching the revenue targets under Gramm-Rudman.

The purpose of the Gramm-Rudman deficit legislation is to reduce the excessive federal demand on credit markets, where government competition with private sector borrowing has kept real interest rates high and forced us to sacrifice our export industries to the government's need for foreign credit.

Selling federal assets does absolutely nothing to reduce the government's presence in the credit market. The deficit may look better on paper but the economic effect is the same: Instead of issuing new bonds to finance a higher deficit, the government will be selling its existing portfolio of agency bonds. Together with the proposed sale of other government assets, this soaks up the same amount of private sector capital as a higher deficit.

Of the remaining $10 billion in revenues raisers, the Administration admits to $6 billion in tax increases. The reality is that the entire $10 billion, including higher Medicare premiums and new user fees, are levies on the American people that are in economic terms no different than a tax increase. These increases amount to $38 billion over the next three years.

The point is that the Administration will not be honest with the American people on the question of federal revenues. The President insists that he will not tolerate tax increases which he believes feed the insatiable growth of the federal government and sap strength from the economy. In reality, however, his proposals to increase payroll taxes, excise taxes, user fees, and Medicare premiums are no different.

The economic fact is that such fees have the same effect on the private economy as do income taxes. They withdraw money private individuals would otherwise spend at their own discretion for purposes the government dictates.

Although the economic effect is the same the President will attack Congress for any mix of tax provisions that include income taxes or otherwise differ from his revenue proposals. That is a recipe for failure.

Many of the Administration's tax increase and user fee proposals have merit. They should be and will be approved by Congress. But many will be rejected, as they have been in the past.

If that is the case, this Committee must have the latitude to make up the difference with additional revenues within its jurisdiction. Congressional budget leaders should be able to sit down with the Administration to make the compromises necessary to make meaningful reductions in the deficit. The economic future of our nation is at stake.

State and local governments have been hit with one wave after another of new fiscal burdens as the federal government has attempted to reduce federal budget deficits.

Last year, Congress terminated the general revenue sharing program at a loss to Maine governments of over $29 million a year. That program was terminated along with cutbacks in Community Development Block Grants and Urban Development Action Grants.

State and local governments are also having to adjust to the new rules on municipal bonds which have severely limit their ability to fund development projects.

In the reconciliation bill that passed Congress last Spring, new state and local employees hired after March 31, 1986 were brought under the Medicare system. Now, in a further scramble for federal revenues the Administration is proposing to cover all state and local employees regardless of when they were hired.

This will impose another $12 million in annual tax burdens on state and local governments in Maine. After all of the fiscal burdens that have already been transferred to the state and local level in the the last three years, I cannot support this proposal to extract more money from our state and local governments.

OPENING STATEMENT BY SENATOR JOHN D. ROCKEFELLER IV

Mr. Chairman, I commend you for holding this hearing.

I share the President's intense commitment to deficit reduction—though I might note that he seemed to repeat his pledge during his State of the Union address to reject "higher taxes" as a means for reaching this essential goal. The fact is, however, that the President's budget contains tax increases and "revenue raisers" totalling over $22 billion. I'm here to learn more about these proposals, to understand their effects on the country and in my state of West Virginia, and to consider their merits and demerits.

I have questions about a number of the Administration's tax proposals, including those which would affect international travel and the railroad retirement system. Today, I would like to make special note of my grave concern about two specific proposals which would have a significant impact on Appalachia: the proposed increase in the coal excise tax and the proposed taxation of black lung disability benefits.

In my view, both of these suggestions should be rejected. Can't this Administration find other sources of extra revenue besides a crippled industry and victims of a debilitating disease? My hope is that this hearing and subsequent forums will convince the President that these proposals are unjustified, unfair, and undeserved.

The proposal to increase the coal excise tax by as much as 60 percent is shocking. I thought coal had successfully dodged the Administration's bullets last year when Congress agreed to a plan to restore the solvency of the Black Lung Trust Fund. Thanks to a joint effort on the part of the coal industry and the United Mine Workers, we were able, as part of the 1986 reconciliation legislation, to limit the tax increase on coal to 10 percent (as opposed to the 50 percent sought by the Administration) and enact a temporary moratorium on interest charged to the trust fund. Those of us in the Senate and the House from coal states remember how hard we worked for this compromise. We succeeded in obtaining a solution to the Trust Fund debt that ensured the Black Lung Program's survival and protected the coal industry from a crippling tax increase. I remain deeply grateful to my distinguished colleagues on this committee, under the chairmanship then of Senator Packwood, for agreeing to this compromise plan.

But rather than wait for our agreement to take effect, the Administration is back with another major tax increase for coal. To impose an extra tax bill of $400 million a year on the coal industry—both underground and surface miners—would devastate that industry.

This is the very time coal is trying to stay alive. The number of operating mines in the U.S. has dropped from 7,000 in 1981 to less than 4,000 today. In West Virginia, between 1981 and 1985, we lost over 23,000 jobs in coal production.

The irony is that this tax proposal comes just when it appears Congress and the President are starting to seriously work on trade and American competitiveness. Coal is one of the industries that is actually trade-positive: $4.5 billion more coal is exported by America than what we import. But it's been far from easy to maintain this. The U.S. coal industry is losing its share of the market in the world economy, with the total amount exported down by 24 percent since 1981.

Can you imagine what our foreign customers would say if a ton of coal were increased by almost 70 cents? Having attempted to convince Japan and other countries to buy West Virginia coal, this would effectively shut us out from the export market.

There is no reason to re-visit the Black Lung Trust Fund debt at this point in time. The measures we adopted in the reconciliation bill will very soon bring the fund into operational solvency and should retire the debt by the year 2014. The Administration should focus its attention elsewhere and leave coal alone. I certainly pledge to do all I can to prevent any more damage from being done to this distressed industry and their workers.

To switch to the proposal dealing with the taxation of black lung disability payments, the arguments again should persuade my colleagues to soundly reject this idea. Though the details are still sketchy, the Administration evidently is seeking to characterize black lung disability payments as partly or entirely "replacement benefits," and treat them as taxable income.

The President's budget only targets black disability for taxation. Analogous programs, such as veterans disability, workers' compensation, and personal injury suits, are all left alone and free of any proposed taxation. The budget singles out one of the most vulnerable segments of our population—the victims of a totally disabling lung disease—for a tax to help with deficit reduction.

This tax is targeted at a segment of the population hovering near the poverty line. In 1982, the Labor Department found that black lung recipients had an average income of $10,000. Moreover, there is no basis for taxing black lung beneficiaries from other recipients of disability benefits. Like disabled veterans, black lung recipients deserve the full value of the compensation they receive for lost wages and extremely high medical bills.

Mr. Chairman, there are better and far more compassionate ways to assist with deficit reduction on the revenue side. I don't think these proposals meet the tests propounded over and over again by the President. They flunk the test of fairness and jeopardize an industry and individuals who cannot tolerate more financial burden.

I sincerely hope Congress and the Administration will turn away from these proposals and focus on ideas that make sense for our nation's future. I pledge to do all I can to help move in this direction.

OPENING STATEMENT BY SENATOR JOHN HEINZ

I welcome this opportunity to examine the President's tax proposals and determine whether these proposals are the best method of achieving our budget goals of $6 billion.

Several of the President's proposals have already been before this committee, some we have passed, others we have rejected and I hope we will continue to reject, and still others are certainly new and innovative ideas. While I have supported some of the President's proposals in the past, there are certain provisions in the President's package, that I am strongly opposed to.

(1) The proposal to expand the employer share of Social Security to include all cash tips is an example of the new ideas that I am strongly opposed to. Social Security is a payroll tax based upon wages paid by the employer. While tips are clearly wages, they are not paid by the employer, they are paid by the customer. Management has no control over whether a customer will tip, or how much they will tip. There appears to be no rational reason to justify the proposed change.

(2) The President's proposal also calls for an increase in the coal excise tax, require the trust fund to pay interest on borrowed funds, and treat black lung benefits paid to disabled coal miners as taxable income.

In 1985 the administration proposed a 50% increase in the coal excise tax. The Ways and Means included the provision in their bill. The Senate, however, included a provision which would have capped the borrowing power of the trust fund. At conference a compromise was worked out with the industry, which I supported. This compromise imposed a 10% coal excise tax increase, and a 5 year moratorium on interest that the trust fund had to pay general revenues. Treasury is now saying that they want to dissolve the compromise. The purpose of the compromise was to make the trust fund solvent, and at the same time not over tax an industry that is still in deep depression. Furthermore the coal industry already has just had a major tax increase imposed as a result of the Tax Reform Act of 1986. Increasing the coal excise tax will only increase the problems of the coal industry and workers that are now suffering from a devastatingly high level of unemployment. Currently this committee is trying to develop solutions to the trade deficit problem. American coal currently has a marginal cost advantage in exports. Increasing the coal excise tax will clearly put them at a competitive disadvantage.

(3) The administration further proposes to treat black lung benefits paid to disabled coal miners as taxable income. This was part of the administration's tax reform proposal in 1985. I was opposed to the idea then, and I am still opposed to the idea. While there are plenty of items in the Tax Reform Act of 1986 that I think we ought to reexamine, this is definitely not one of them. Many of the black lung victims live below or near the proverty line. A Department of Labor study released in 1983 showed that miner and widow beneficiaries, on the average, had a total 1982 household income, from all sources, of $9,870. This compares with a median U.S. family income of $24,187 in 1982. Taxing black lung benefits will raise very little revenue, yet it will cause tremendous hardships for the recipients.

(4) Regarding Railroad Retirement, the administration proposal is to increase the payroll tax for the Railroad Retirement Program. I fail to see the necessity of this action. We passed comprehensive financing legislation to restore solvency in the Railroad Retirement Program just a few years ago raising the total payroll tax from 15.5 to 19 percent of wages. Now the administration is proposing an increase to 22%, even though there is every indication that the Railroad Retirement Fund is in good financial condition. It would be a mistake to fiddle with this pension system simply to raise revenue.

(5) On the subject of the premium increase for the Pension Benefit Guaranty Corporation, let me say that the PBGC is heading for very serious financial trouble that is not going to be solved by simply raising the premium on pension plans. I would hope that as this committee looks at this financing problem we see more than just an opportunity to raise revenue. The future of the whole system of guarantees for pension benefits is at stake. We more than tripled the premium last year and while we were doing that, PBGC's unfunded liabilities doubled. What we have is a spiraling effect, higher premiums leading to more plan terminations leading to higher premiums. We need a more carefully thought through solution than just a premium increase.

STATEMENT OF SENATOR DAVE DURENBERGER

Mr. Chairman, during the past three weeks, this Committee has held several hearings devoted to the position of the U.S. economy in the context of the global trading system. We have heard from a broad spectrum of witnesses including representatives of the business community, members of organized labor, and distinguished economists.

If there was a single thread that linked the testimony of nearly all of those witnesses, it was the urgent need for Congress and the Administration to make a serious effort at reducing the federal budget deficit. Without serious and meaningful deficit reduction, this nation's trade deficit will not be rectified.

This morning we will consider some of the revenue proposals contained in the Administration's budget. Although the Administration claims that it's budget will reach the $108 billion target mandated by Gramm-Rudman, I am skeptical of their economic assumptions and dubious of their revenue estimates.

I want to draw the Committee's attention to one proposal in the Administration's budget that this Committee has previously rejected and which, I believe should be rejected again this year. I refer to the proposal to repeal the excise tax exemptions for gasohol and the income tax credit for alcohol fuels.

The proposal to end the six cent per gallon exemption from the gasoline and diesel fuel excise taxes is short-sighted and fiscally irresponsible. For the last three weeks, we have heard several witnesses warn of the economic dangers confronting our economy unless we alleviate our foreign trade deficit. Certainly, anything we can do to lessen our dependence on foreign oil will reduce that deficit, while at the same time assuring our nation's national security.

Mr. Chairman, to cut the rug out from under the nation's fledgling gasohol industry at this time makes absolutely no sense. Our dependence on foreign oil has been growing at a dangerous rate. Last year, oil imports went up from 27 percent to more than 40 percent. And OPEC's share has also been rising—from 36 percent in 1985 to more than 43 percent today. This is a dangerous trend, especially in light of the political uncertainties surrounding events in the Middle East where a battle has been raging for weeks to control Iraq's second largest city, Basra.

Encouraging motorists to use gasoline blended with ethanol will also increase market opportunities for our nation's grain farmers who are enduring a seemingly unending economic depression while the Federal government foots a multi-billion dollar bill to store their surplus grain.

There are currently more than 100 ethanol production facilities in the United States. More than $2 billion of private sector money has been invested in this industry which last year utilized more than 300 million bushels of American grain. As a result of this new market for grain, it is estimated that the Commodity Credit Corportion saved nearly $200 million in grain storage costs. The increased market for grain also raised the price of corn by about 10 cents per bushel. That means the Agriculture Department saved nearly $600 million in deficiency payments.

I would add that in 1986 alone, the production for ethanol added an estimated $900 million to farm income and created tens of thousands of jobs in hard pressed communities across rural America.

We should not ignore the fact that ethanol is a proven high-quality octane enhancer that is an environmentally benign replacement for lead in gasoline. There is absolutely no doubt that the health and welfare of our nation's populace will be significantly enhanced by replacing lead in gasoline with gasohol.

Mr. Chairman, the simple question is whether we want to find creative ways to use up our surplus grain and benefit our farmers and reduce the cost of our farm programs, or do we want to go back to the wasteful ways of the 70s when our dependence on foreign producers of oil caused our nation's economy to come to a screeching halt. I think the answer is clear. At a minimum, we should retain preferential treatment for gasohol.

SUMMARY OF REVENUE PROVISIONS IN THE PRESIDENT'S FISCAL YEAR 1988 BUDGET PROPOSAL

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

This pamphlet,[1] prepared by the Staff of the Joint Committee on Taxation, provides a summary of the revenue provisions in the President's Fiscal Year 1988 Budget, submitted to Congress on January 5, 1987.

The first part of the pamphlet is a summary of the revenue proposals contained in the Fiscal Year 1988 Budget, including present law and a reference to prior action on the topic. The second part of the pamphlet presents the Administration's estimates of the revenue effects of the proposals, as they affect budget receipts.

The pamphlet generally does not describe the President's budget proposals relating to user fees or charges (other than the proposed Coast Guard user fees and proposed increase in PBGC premiums) that are not treated as "budget receipts." The pamphlet also does not include budget proposals relating to an increase in the District of Columbia employer contributions to Civil Service Retirement, Nuclear Regulatory Commission fees, or certain other similar user fee proposals which are included as budget receipt items in the President's budget.

The pamphlet also does not describe the President's Competitiveness Initiative, announced on January 27, 1987. The revenue-related portions of that initiative propose—

(a) decentralization of the financing and responsibility for the unemployment insurance program;

(b) provisions increasing legal and regulatory flexibility for research and development in the R&D tax credit, as well as certain Treasury rulings on allocation of these expenditures under Code section 861; and

(c) amending the Employee Retirement Income Security Act of 1974 ("ERISA") with regard to overfunded defined benefit pension plans and making ERISA less lenient in dealing with employer underfunding of defined benefit pension plans.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Summary of Revenue Provisions in the President's Fiscal Year 1988 Budget Proposal* (JCS-2-87), February 3, 1987.

I. SUMMARY OF REVENUE PROVISIONS

A. Tax Provisions

1. Extension of Medicare Payroll Tax to All State and Local Government Employees

Present Law

Before enactment of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) (P.L. 99-272), State and local government employees were covered for Social Security and Medicare benefits only if the State and the Secretary of Health and Human Services (HHS) entered into a voluntary agreement providing such coverage. In COBRA, the Congress extended Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to State and local government employees hired after March 31, 1986, for services performed after that date. Under present law, State and local government employees hired before April 1, 1986, still are not covered for Medicare unless a voluntary agreement is in effect. Currently, 70 percent of all State and local government employees are covered under a voluntary agreement. Medicare coverage (and the hospital insurance payroll tax) is mandatory for Federal employees.

For wages paid in 1987 to Medicare-covered employees, the total hospital insurance tax rate is 2.9 percent of the first $43,800 of wages (secs. 3101, 3111, and 3121(a) of the Internal Revenue Code). One-half of this tax is paid by the employee and one-half is paid by the employer.

President's Budget Proposal

The President's budget proposal would extend Medicare coverage on a mandatory basis to all employees of State and local governments not otherwise covered under present law, without regard to their dates of hire. These employees and their employers would become liable for the hospital insurance portion of the FICA tax, and the employees would earn credit toward Medicare eligibility based on their covered earnings.

This proposal would be effective January 1, 1988.

Prior Action

During the 99th Congress, the Senate amendment to H.R. 5300 (the Omnibus Budget Reconciliation Act of 1986 (OBRA)) included a provision similar to the President's budget proposal. This provision was deleted from OBRA before its enactment.

2. Expansion of Employer Share of FICA Tax to Include All Cash Tips

Present Law

Under present law, an employee must report to his or her employer all tips, and the employer is responsible for withholding the employee's FICA tax on these tips (Code sec. 3121(t)). The employer is not required to pay the employer's FICA tax on these tips unless the wages paid to the employee are less than the Federal minimum wage. In that event, the employer is required to pay the employer's FICA tax on a portion of tips received. Specifically, the employer pays the employer's tax on the difference between actual wages paid to the employee by the employer and the Federal minimum wage.

President's Budget Proposal

Under the President's budget proposal, all tips would be treated as wages for purposes of the employer FICA tax.

This proposal would be effective October 1, 1987.

3. Extend FICA Tax to Inactive Duty Earnings of Military Reservists and Certain Other Earnings

Present Law

The Social Security System is financed by payroll taxes imposed under the Federal Insurance Contributions Act ("FICA"). The 1987 rates of this tax are 7.15 percent paid by employers and 7.15 percent paid by employees on wages (up to a maximum of $43,800). The Act generally defines wages to include all remuneration for employment but provides specific exemptions.

President's Budget Proposal

The President's budget proposal would eliminate the exemption from the definition of wages for several categories of earnings. The exemption would be repealed for the following:

(a) wages received by Armed Services reservists for inactive duty (e.g., weekend or short-term reserve duty) (currently exempt under sec. 3121(b)(5));

(b) student earnings that currently are exempted under sections 3121(b)(6)(B), 3121(b)(10), and 3121(b)(13) (e.g., student employees of their colleges); and

(c) certain excluded family employment, i.e., earnings provided to a man who works for his wife, a woman who works for her husband, or a child under the age of 21 who works for his or her parents (currently exempt under sec. 3121(b)(3)(A)). Under present law, children over the age of 20 who work for their parents are subject to these FICA taxes.

In addition, the President's proposal would extend FICA tax coverage to agricultural wages currently partially exempt under section 3121(a)(8).

These proposals would be effective January 1, 1988.

4. Treatment of Group-Term Life Insurance as Wages Under FICA

Present Law

The cost of group-term life insurance provided by an employer to an employee is excluded from the definition of wages for purposes of the FICA tax (sec. 3121(a)(2)). In 1987, the first $43,800 of wages is subject to a total FICA tax of 14.3 percent (secs. 3101, 3111, and 3121(a)). One-half of this tax is paid by the employee and one-half is paid by the employer.

For income tax purposes, in general, the cost of employer-provided group-term life insurance is includible in an employee's gross income to the extent that the coverage exceeds $50,000. Employer-provided group-term life insurance also is included in an employee's gross income if the coverage is provided on a discriminatory basis.

President's Budget Proposal

Under the President's budget proposal, employer-provided group-term life insurance would be included in wages for FICA tax purposes if such insurance were includible in gross income for income tax purposes.

This proposal would be effective January 1, 1988.

5. Railroad Retirement Tax Proposals

a. Increase in railroad retirement payroll tax

Present Law

The primary source of income to the railroad retirement account is payroll taxes levied on covered employers and their employees. Currently, both employers and employees pay a Tier I tax which is equivalent to the social security tax rate. In addition, a Tier II tax is paid by both rail employers and employees. These taxes are applied to compensation paid to employees, up to a maximum annual amount. Under present law, the Tier II tax rate is 14.75 percent for employers and 4.25 percent for employees. The Tier II wage base in 1987 is $32,700.

President's Budget Proposal

The President's budget proposal would increase the railroad retirement Tier II taxes by 3.0 percentage points. This increase would be achieved in two steps—a 1.5 percentage point increase, effective January 1, 1988, and an additional 1.5 percentage point increase effective January 1, 1989. Additionally, it is understood that the President's budget proposal will include as yet undetermined proposals on rail sector financing of vested dual, or "windfall," benefits.

b. Extension of FUTA tax to railroad employment

Present Law

Under present law, railroad employment is not covered by the Federal-State unemployment insurance system. Instead, railroad employees are covered by a separate Railroad Sickness and Unemployment Insurance Fund, which is financed by payroll taxes levied on rail employers.

The railroad unemployment insurance (RRUI) program has permanent authority to borrow from the railroad retirement program in order to pay RRUI benefits. The Railroad Retirement Solvency Act of 1983, as modified by the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), established a loan repayment tax, beginning at 4.3 percent on July 1, 1986, and changing to 4.7 percent for 1987, 6.0 percent for 1988, 2.9 percent for 1989, and 3.2 percent for 1990. The tax expires after September 30, 1990.

COBRA further provided that an automatic surcharge of 3.5 percent on the loan repayment tax base will be levied if the RRUI program has to borrow from the retirement program. The surtax proceeds are to be used to repay such loans made after September 30, 1985, and is in effect for any year if on September 30 of the prior year any principal or interest from a loan after September 30, 1985 remains unpaid.

President's Budget Proposal

The President's budget proposal would extend coverage under the Federal-State unemployment insurance system to railroad employment. In addition, a transitional program would be developed to guarantee certain levels of benefits for rail workers who became unemployed after September 30, 1987. The Railroad Sickness and Unemployment Insurance Fund would continue to finance sickness payments and to repay the Fund's debt to the rail industry pension fund.

This proposal would be effective October 1, 1987.

Prior Action

This provision has been included in prior years' budget proposals submitted by the President.

6. Repeal of Current Gasohol, Bus, and State and Local Government Highway Excise Tax Exemptions

Present Law

Revenues from excise taxes on motor fuels, tires, and trucks and trailers, and a use tax on heavy highway vehicles, are deposited in the Highway Trust Fund. Trust Fund monies are used to finance authorized expenditures from the Highway Trust Fund. These Highway Trust Fund excise taxes are scheduled to expire after September 30, 1988.[2] Exemptions from all or part of some of these excise taxes have been provided for fuels containing alcohol, for private and public bus operators, and for State and local governments.

Alcohol fuels.—An exemption of 6 cents per gallon is provided for gasohol blends (i.e., 10 percent pure alcohol) of diesel, gasoline, and special motor fuels. (The current general tax rate is 15 cents per gallon for highway diesel fuel and 9 cents per gallon for gasoline and special motor fuels.) A 6-cents-per-gallon exemption also is provided for neat methanol and ethanol fuels which contain at least 85-percent alcohol produced from a substance other than petroleum or natural gas. A 4-1/2-cents-per-gallon exemption is available for such alcohol blends produced from natural gas. These alcohol fuels exemptions are scheduled to expire after December 31, 1992.

Buses.—Private and public bus operators are exempt from the excise tax on tires.[3] Intercity common carrier buses, school buses, and qualified local buses are exempt from the 9-cents-per-gallon taxes on gasoline and special motor fuels. School buses and qualified local buses are also exempt from the 15-cents-per-gallon diesel fuel tax. In addition, private intercity buses receive a 3-cents-per-gallon refund (or credit) of the 15-cents-per-gallon highway diesel fuel tax. Nonqualified local buses[4] receive no exemption.

State and local governments.—Otherwise taxable products or articles used by States and local governments are exempt from all Highway Trust Fund excise taxes.

President's Budget Proposal

Under the President's budget proposal, the exemptions from Highway Trust Fund excise taxes for alcohol fuels, buses, and State and local governments would be repealed.

This proposal would be effective October 1, 1987.

Prior Action

The President proposed repealing the alcohol fuels and bus exemptions in his budget proposal for fiscal year 1987. The President also proposed repeal of the excise tax exemptions for gasohol and income tax credit for alcohol fuels as part of his 1985 Tax Reform Proposal. Those proposals were not adopted as part of either the 1987 budget measure or tax reform legislation enacted in 1986.

The Tax Reform Act of 1986 (P.L. 99-514) reduced the exemption for neat alcohol fuels from 9 cents to 6 cents per gallon, for sales or uses after 1986.

The House of Representatives has approved a bill (H.R. 2) extending the Highway Trust Fund taxes and expenditure authority for five years, through September 30, 1993. The Senate Committee on Finance has approved a four-year extension amendment to be offered to S. 387, a bill extending highway authorizations for four years, when S. 387 is considered by the Senate.

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[2] *See* the discussion below on *Prior Action* for the status of pending highway excise tax legislation.

[3] The excise tax on tires currently applies to highway tires (other than bus tires) weighing more than 40 pounds, with a graduated tax up to a maximum of $10.50 plus 50 cents per pound in excess of 90 pounds (sec. 4071).

[4] No exemption is available for buses engaged in transportation that is not scheduled and is not along regular routes, unless the seating capacity of the bus is at least 20 adults (not including the driver).

7. Black Lung Benefit Tax Proposals

a. Increase in coal excise tax

Present Law

Producers of domestically mined coal (other than lignite) pay an excise tax on sales of coal. Since April 1, 1986, the excise tax rates have been $1.10 per ton of coal from underground mines, and 55 cents per ton of coal from surface mines, except the amount of tax may not exceed 4.4 percent of the sales price.

Amounts equal to the revenues collected from the coal excise tax are appropriated automatically to the Black Lung Disability Trust Fund. The Trust Fund pays certain black lung disability benefits to coal miners (or their survivors) who have been disabled by black lung disease in cases where no coal mine operator is found responsible for the individual miner's disease. Present law includes an unlimited authorization for advances, repayable with interest, from general revenues to the Trust Fund. In the Consolidated Omnibus Budget Reconciliation Act of 1985, a 5-year moratorium was provided on interest accruals with respect to any repayable advance occurring after September 30, 1985, and before October 1, 1990.

The tax will revert to 50 cents on underground coal, 25 cents on surface coal, and a limit of 2 percent of price on the earlier of January 1, 1996, or the first January 1 as of which there is (1) no balance of repayable advances made to the Trust Fund, and (2) no unpaid interest on such advances.

President's Budget Proposal

The President's budget proposal would increase the excise tax receipts to the Trust Fund by $357 million in fiscal year 1988. The proposal does not include specific tax rates; however, the $357 million amount is 54 percent of estimated receipts in fiscal year 1988 under present law. Thus, the proposal when transmitted may be expected to recommend increases of approximately 50 percent in the coal excise tax.

The Administration estimates that these excise tax changes, and other changes relating to interest payments and certain as yet unspecified benefit reforms, would eliminate the Trust Fund deficit by the year 2007. As of the beginning of Fiscal Year 1987, the deficit was $2.88 billion.

This proposal would be effective October 1, 1987.

b. Treatment of black lung income maintenance benefits as taxable income

Present Law

Title IV of the Federal Coal Mine Health and Safety Act of 1969 provided benefits for miners totally disabled by black lung disease and for dependents of miners who had died from the disease or were totally disabled from the disease at death. The 1969 act was amended by the Black Lung Benefits Act of 1972, the Black Lung Benefits Reform Act of 1977, the Black Lung Revenue Act of 1977, and the Black Lung Benefits Revenue Act of 1981.

Black lung benefits reimburse disabled coal miners who have black lung disease for medical costs and lost income. These benefits are not taxable under present law.

President's Budget Proposal

The President's proposal would make the income maintenance portion of black lung benefits includible in the recipient's gross income.

This proposal would be effective January 1, 1988.

8. Extension of Airport and Airway Trust Fund Excise Taxes

Present Law

Excise taxes are imposed on users of the Federally financed aviation system. Receipts from these taxes are deposited into the Airport and Airway Trust Fund, and expenditures may be made from the Trust Fund for purposes authorized in the Trust Fund statute in the Internal Revenue Code.

The airport and airway excise taxes include —

(1) an 8-percent tax on air passenger transportation;

(2) a 5-percent tax on domestic air transportation of property;

(3) a $3 per person international departure tax;

(4) a 12-cents-per-gallon tax on gasoline used in noncommercial aviation;[5] and

(5) a 14-cents-per-gallon tax on nongasoline fuels used in noncommercial aviation.

Exemptions from the fuels excise taxes have been provided for aircraft museums and for certain helicopter uses which do not utilize the facilities and services of the Federal airport and airway system.

The taxes on air transportation apply to the purchase of transportation services for persons or property beginning before January 1, 1988. The taxes on noncommercial aviation fuels expire after December 31, 1987.

President's Budget Proposal

The President's budget proposal would extend the present-law airport and airway system excise taxes for two additional years (i.e., through December 31, 1989, and would provide a two-year reauthorization of the Airport and Airway Trust Fund programs (fiscal years 1988–1989).

9. Imposition of Air and Ship Travel Tax

Present Law

Present law imposes no general excise tax on international travel to and from the United States. A $3 per person international departure tax is imposed, however, as part of the funding for the Airport and Airway Trust Fund, applicable to certain international flights exempt from the 8-percent domestic passenger ticket tax. (*See* 8., above.)

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[5] The 12-cents-per-gallon tax is composed of the regular 9-cents-per-gallon tax on gasoline and a special 3-cents-per-gallon add-on tax.

President's Budget Proposal

The President proposes to impose an excise tax of $1 per ticket for international travel to and from the United States, its possessions, and its territories by airline or cruise ship carriers. Travel to and from Canada, Mexico, and travel to the United States that originates in U.S. possessions and territories would be exempt from the tax.

Revenue from this tax would be used to support international tourism and marketing activities, defined to include planning, developing and carrying out programs to stimulate and encourage foreigners to travel in the United States. The proposal would fund the $12 million annual budget of the U.S. Travel and Tourism Administration; any revenues collected in excess of the existing USTTA budget would go into the general fund of the Treasury.

This proposal would be effective January 1, 1988.

10. Repeal of Crude Oil Windfall Profit Tax

Present Law

Present law imposes an excise tax (the "crude oil windfall profit tax") on the windfall profit element of the price of domestically produced crude oil when it is removed from the premises on which it was produced. Generally, the windfall profit element is the excess of the sale price over the sum of an adjusted base price plus the applicable State severance tax adjustment. The windfall profit element may not exceed 90 percent of net income attributable to a barrel of crude oil.

The tax rates and recent base prices applicable to taxable crude oil are as follows:

Category of Oil	Tax Rate (percent)	Estimated Base Price* (dollars per barrel)
Tier-1 Oil (Oil Not in Tiers 1 or 2)		
Integrated producer	70	$18.49
Independent producer	50	19.07
Tier-2 Oil (Stripper and Petroleum Reserve Oil)		
Integrated producer	60	20.89
Independent producer	30	NA
Tier-3 Oil		
Newly discovered oil	**22.5	27.59
Incremental tertiary oil	30	27.13
Heavy oil	30	23.11

*Estimate for fourth quarter of 1986 based on *SOI Bulletin* (Summer 1986). The estimated base price for Tier-1 oil excludes North Slope oil.

**Phases down to 20 percent in 1988 and 15 percent in 1989 and subsequent years.

Independent producer stripper well oil is exempt from the tax. Additionally, crude oil from a qualified governmental or a qualified charitable interest, certain front-end oil, certain Indian oil, certain Alaskan oil and, in the case of qualified royalty owners, up to three barrels per day of royalty production, are exempt from the tax.

The windfall profit tax is scheduled to phase out over a 33-month period, beginning January, 1991, or earlier if revenues from the tax exceed a specified amount.

President's Budget Proposal

The President's budget proposal would repeal the crude oil windfall profit tax.

This proposal would be effective October 1, 1987.

Prior Action

The Treasury Department's 1984 tax reform study proposed an immediate phase-out of the windfall profit tax as part of its comprehensive proposal on the taxation of the oil and gas industry.[6] However, this provision was not included in the President's 1985 Tax Reform Proposal or in the Tax Reform Act of 1986.

During the 99th Congress, the Senate approved legislation that would have repealed the windfall profit tax, effective October 1, 1987. The provision was a floor amendment to H.J. Res. 668, a bill to increase the Federal debt limit. H.J. Res. 668 was not enacted.

11. Imposition of Coast Guard User Fees

Present Law

The Coast Guard provides various services to recreational and commercial boaters, including inspections, licenses, navigation aids, and search and rescue operations. These services are funded from general revenues.

President's Budget Proposal

The President's budget proposes a phased implementation of user fees for certain Coast Guard services. According to the proposal, fees for direct, transactional services (e.g., issuing licenses) would be set so as to recover the actual cost of providing the service. Additional fees on as yet unspecified activities sufficient to finance other services would be set in proportion to the Coast Guard's cost of providing the service to each class of users (e.g., recreational, commercial fishing, and deep-sea and inland commercial users).

No fees would be charged for core governmental functions carried out by the Coast Guard (e.g., defense, law enforcement, and polar ice operations).

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[6] *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, November, 1984, Volume II, p. 243.

The budget proposal estimates total fees of $355 million in fiscal year 1988 and $474 million annually thereafter, but does not specify the fee structures.

This proposal would be effective October 1, 1987.

B. PBGC Premiums

Present Law

Under present law, if a defined benefit pension plan is terminated by a sponsoring employer with assets insufficient to pay benefits guaranteed by the Pension Benefit Guaranty Corporation (PBGC), then the PBGC pays the monthly benefits required by the particular plan, up to the guaranteed levels. Subject to certain dollar limits, the PBGC guarantees nonforfeitable retirement benefits other than those that become nonforfeitable on account of the termination of the plan.[7]

Under the Single-Employer Pension Plan Amendments Act of 1985 (SEPPA), the sponsor of a single-employer defined benefit plan may terminate the plan only in a standard termination or a distress termination. A standard termination occurs when the assets in the plan are sufficient to pay all benefit commitments. Benefit commitments generally include all benefits guaranteed by the PBGC and all benefits that would be guaranteed but for the insurance limits on the amounts or value of the benefits. In a standard termination, the plan sponsor has no further liability to the PBGC after plan termination.

A distress termination occurs in certain cases of financial hardship, such as bankruptcy, the inability of the sponsor to pay its debts when due unless the plan is terminated, or if pension costs become unreasonably burdensome due to a declining workforce. In the case of a distress termination, the sponsor is liable to the PBGC for the sum of (1) the total amount of all unfunded guaranteed benefits, up to 30 percent of the employer's net worth, (2) an amount equal to the excess (if any) of (a) 75 percent of the total amount of all unfunded guaranteed benefits over (b) the amount described in (1), and (3) interest on the amount due calculated from the termination date.

PBGC revenues include per-participant annual premiums charged to all employers with defined benefit pension plans, earnings on investments, and collections from sponsors of terminated plans. Single-employer plans currently pay an annual premium of $8.50 per participant. The PBGC has limited authority to impose a variable rate premium.

Under present law, employers are required to meet certain minimum funding standards with respect to a defined benefit pension plan.

President's Budget Proposal

Despite the 1986 increase in the premium rate (from an annual per-participant premium of $2.60 to $8.50) and the SEPPA restrictions on the circumstances in which employers may terminate underfunded pension plans and shift pension liabilities to the PBGC, the termination of underfunded pension plans in failing companies is projected to increase the PBGC's deficit from $2.3 billion at the end of 1986 to $4.2 billion by the end of 1988. Cash payments to retired workers are estimated to exceed PBGC income in 1988, depleting its already inadequate reserves.

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[7] Present law requires that all benefits become nonforfeitable when a pension plan is terminated.

The President proposes to authorize the PBGC to charge higher premiums to those employers who do not adequately fund their pension promises. The current minimum funding requirements would be revised in as yet unspecified ways to protect both the pensions expected by workers and the PBGC.

The proposal would be effective January 1, 1988.

C. IRS Funding

Present Law

In fiscal year 1986, the IRS had approximately 96,000 employees with a total budget of approximately $3.8 billion.

President's Budget Proposal

The President's budget proposal would increase IRS funding in fiscal year 1988 by approximately $700 million, which the proposal estimates would increase fiscal year 1988 receipts by $2.4 billion. This increase would be in addition to the $5.0 billion in fiscal year 1988 receipts that the Administration estimates (in its current receipts estimates included in the budget proposal) will result from the combination of tax reform, recent increases in penalties, and more effective enforcement.

D. Certain New Treasury Department User Fees

1. Internal Revenue Service

Present Law

The Internal Revenue Service (IRS) currently does not charge taxpayers for issuing determination letters or private ruling letters. In 1984, the IRS issued 106,353 advance determination letters on the qualification of corporate and self-employed pension plans, and acted on 69,613 applications and ruling requests from tax-exempt organizations. The IRS also issued 34,246 private ruling letters in response to taxpayers' requests during 1984.

President's Budget Proposal

The President's budget proposes to impose user fees for each determination letter and private ruling letter issued by the IRS. The level of the fees is not specified. These fees are proposed to become effective on October 1, 1987.

Prior Action

This proposal has been included by the President in prior years' budget proposals.

2. Bureau of Alcohol, Tobacco, and Firearms

Present Law

The Treasury Department's Bureau of Alcohol, Tobacco, and Firearms (BATF) collects licensing fees and excise taxes on various types of firearms, pursuant to the Federal Gun Control Act (19 U.S.C. sec. 921 *et seq.*) and Code sections 5801-5872.

The Code imposes occupational taxes on brewers (sec. 5091) and on wholesale and retail dealers in liquor, wine and beer (secs. 5111 and 5121). The amount of these taxes ranges from $24 per year for retail beer dealers to $255 per year for wholesale liquor and wine dealers. BATF generally does not charge fees for permits related to alcohol and tobacco products.

President's Budget Proposal

The President's budget proposes increasing fees for services provided by BATF. It is understood that these proposals, when transmitted, may include an increase in firearms licensing fees; imposition of fees for permits to produce alcoholic beverages (pursuant to the Federal Alcohol Administration Act), to engage in certain industrial uses of alcohol (pursuant to Code sec. 5171(d)), and to procure or use certain tax-free[8] or specially denatured distilled spirits (pursuant to Code sec. 5271); and imposition of licensing fees for occupations presently covered by alcohol occupational taxes. Similar fees would also be imposed on tobacco-related permits.

This proposal would be effective October 1, 1987.

E. Customs Service User Fee

Present Law

As enacted in the Omnibus Budget Reconciliation Act of 1986, an *ad valorem* user fee is applied to all formal entries of merchandise imported for consumption in the amount of 0.22 percent during fiscal year 1987, dropping to 0.17 percent in fiscal year 1988, and expiring after September 30, 1989. The fees do not apply to articles classifiable in schedule 8 of the Tariff Schedules (including products containing U.S. components which are classifiable in item 807.00 of the Schedules).

President's Budget Proposal

The President's budget proposal would eliminate the exemption for articles containing U.S. components and would extend the fee beyond its scheduled expiration date.

The proposal would be effective July 1, 1986.

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[8] Tax-free uses covered by this provision include certain uses by State or local governments or for specified nonbeverage purposes (including laboratory and hospital uses).

II. ADMINISTRATION'S ESTIMATED BUDGET EFFECTS OF PRESIDENT'S REVENUE PROPOSALS, FISCAL YEARS 1987–1990

[Billions of dollars]

Provisions	1987	1988	1989	1990	1987–90 [1]
A. Tax Provisions:					
1. Extension of Medicare Payroll Tax to all State and Local Government Employees	....	1.6	2.2	2.2	6.0
2. Expansion of Employer Share of FICA Tax to Include All Cash Tips	....	0.2	0.3	0.3	0.9
3. Extension of FICA Tax to Inactive Duty Earnings of Military Reservists and Certain Other Earnings	....	0.2	0.3	0.3	0.8
4. Treatment of Group-Term Life Insurance as Wages under FICA	....	(*)	0.1	0.1	0.2
5. Railroad Retirement Tax Proposals:					
a. Increase in railroad retirement payroll tax	....	0.2	0.4	0.4	1.0
b. Extension of FUTA tax to railroad employment	....	0.1	0.2	0.2	0.4
6. Repeal of Current Gasohol, Bus, and State and Local Government Highway Excise Tax Exemptions	....	0.6	0.6	0.6	1.8
7. Black Lung Benefit Tax Proposals:					
a. Increase in coal excise tax	....	0.3	0.3	0.3	0.8
b. Treatment of black lung income maintenance benefits as taxable income	....	(*)	0.2	0.1	0.4
8. Extension of Airport & Airway Trust Fund Excise Taxes	....	1.6	2.8	3.0	7.4
9. Imposition of Air and Ship Travel Tax	....	(*)	(*)	(*)	(*)
10. Repeal of Crude Oil Windfall Profit Tax	....	....	....	....	....
11. Imposition of Coast Guard User Fees	....	0.4	0.5	0.5	1.3
B. PBGC Premiums [2]	....	−0.2	−0.4	−0.4	−1.0
C. IRS Funding	....	2.4	3.1	3.3	8.8

D. Certain New Treasury Department User Fees:					
1. Internal Revenue Service	....	0.1	0.1	0.1	0.2
2. Bureau of Alcohol, Tobacco and Firearms	....	0.1	0.1	0.1	0.2
E. Customs Service User Fee	(*)	0.1	0.1	0.5	0.7

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[1] Totals may not add due to rounding.
[2] This provision is characterized by negative budget outlays rather than revenue increases.
* Less than $50 million.

Source: Office of Tax Analysis, Department of the Treasury.

The CHAIRMAN. The hearing will come to order.

Senator Murkowski, if you will take a seat we will get under way. I understand you are supposed to be attending to responsibilities over on the floor of the Senate, and we apologize to you for the delay. We have been having a meeting in the back room, going over what the legislation is in the Trade Bill, which we frankly hope to introduce tomorrow morning.

Senator Murkowski, the distinguished Senator from the State of Alaska, we are pleased to have you here to testify.

STATEMENT OF HON. FRANK H. MURKOWSKI, U.S. SENATOR FROM THE STATE OF ALASKA

Senator MURKOWSKI. Thank you very much, Mr. Chairman. I appreciate the courtesy extended to me to accommodate my schedule, and I certain recognize the importance of the trade legislation pending before the Senate.

I am testifying this morning in opposition to a proposal in the Administration's Fiscal 1988 budget that extends mandatory Medicare hospital insurance coverage to all presently uncovered state and local public employees. It is my analysis that, if adopted, the proposal will require all states and local public employees to pay 1.45 percent of their first $43,200 in pre-tax wages for Medicare hospital insurance. The proposal also would require state or local government employers to contribute a corresponding matching amount.

My opposition to extended coverage is primarily for two reasons. First, it would create a substantial financial burden on state and local governments, especially those already severely economically depressed. Second, it would place a new payroll tax on four to five million middle class working people.

A similar proposal to extend Medicare hospital insurance coverage to all state and local public employees failed in the last session's Reconciliation Bill, and for good reason—it was untimely and unnecessary. We worked long and hard on the Tax Reform Act of 1986 to avoid new taxes on individuals. The President made it clear then that he opposed any new individual tax hikes.

Mandatory Medicare coverage was also unnecessary last session, because our present law is adequate. Estimates show that state and local public employees turnover is at an annual rate of 9 percent. Eventually, all state and local public employees would be covered under Medicare.

Our Omnibus Reconciliation Act of last session extended mandatory Medicare hospital insurance coverage only to those state and local public employees hired after March 31, 1986. This law now allows for a gradual phase-in of mandatory coverage, thereby making it easier for state and local governments to adjust to the substantial financial costs, accounting, and program changes associated with mandatory coverage.

But, Mr. Chairman, despite the good results we achieved last session, we are asked once again to revisit mandatory Medicare coverage that will impose substantial financial difficulty on state and local governments, as well as individuals.

We revisit this issue at a time when so many states are experiencing hardships caused by declining revenues and struggling to make ends meet. I would also remind my colleagues on the Finance Committee that we are revisiting this issue after the Congress denied revenue sharing to state and local governments.

I think we need to look at a few examples to see the adverse impact: The percentage of public employees affected in Illinois was as high as 62 percent; in California, 60 percent; in Connecticut, 43; in Texas 46; Louisiana, 84, and the list goes on.

If Congress requires individual employees to contribute to mandatory coverage, we would be directly affecting the pocketbooks of a large number of our citizens. Consider that a $25,000-a-year public employee would lose from his or her paycheck an additional $356 each year to pay for the Medicare tax.

In conclusion, Mr. Chairman, I am concerned about how the new proposal may tamper with or jeopardize the several alternative state and local medical benefit plans that successfully exist now in many other states. Those state and local governments who have taken the initiative to set up their own plans are the ones that would be penalized.

I am also concerned that this proposal would seriously affect those states that are experiencing economic downturns that I have mentioned.

I would ask that the balance of my statement, Mr. Chairman, be put in the record. I think that some of my colleagues at least would agree that we worked out a good solution to mandatory Medicare coverage last session. Government employers and new employees would have to contribute to Medicare after March 1986; therefore, Congress adopted a reasonable phase-in of mandatory coverage. I think this gives all concerned a good chance to adjust.

I thank you for accommodating me, and I would be happy to respond to questions.

The CHAIRMAN. Senator Murkowski, I well understand your concerns, whether it is the state employee in Alaska or the schoolteacher in Texas. Their wages are certainly going to be affected by having to participate in the Medicare program.

I would like to now open it up. Since everyone was here at 10:00, I will not follow the so-called early-bird rule, but I would ask that anyone who has questions do so now.

Senator MITCHELL. Mr. Chairman, I don't have a question but I have an opening statement that I ask be put in the record at the appropriate point.

The CHAIRMAN. Thank you. We will do that, without objection.

Senator MITCHELL. I just wanted to say that, as you know, this issue came up in the committee, and I took the position that the Senator has just set forth. My statement deals with that in some detail.

I commend the Senator for his statement, and I welcome his participation in this issue. I think he is correct, and we are going to press that point of view as best we can.

Senator MURKOWSKI. Thank you, Senator.

The CHAIRMAN. Are there any other questions?

Senator DURENBERGER. In the last six years I shared the Intergovernmental Relations Subcommittee of Governmental Affairs, and I sat in here and dealt with this issue, as we have from time to time, and I think Frank is clearly right when he speaks to the intergovernmental consequences of the recommendations.

One of the things we had before us last year as I recall, Frank, when we were doing tax reform, is some of the other opportunities that public employees at the state and local level might have, such as access to 401(k) and other forms of contributory savings.

I recall at one point in that negotiation that, in order to pick up some of the advantages of the so-called "equity," herein having everyone contribute to the Medicare tax, there would be a kind of trade-off where we would in effect say the public employees ought to have access like private employees do to all of these other plans.

I don't recall that that happened; in fact, I think somewhere either here or in conference that part got wiped out. Do you recall whether I am correct in that regard, that public employees now really don't have the same access to some of these 401(k) and other plans that the rest of the people have?

Senator MURKOWSKI. I really am not knowledgeable on the specifics of that.

Senator DURENBERGER. Isn't it also true that a lot of the pension plans, particularly at the local government level, are grossly underfunded? We talk about police and fire and small units of government.

Senator MURKOWSKI. Yes.

Senator DURENBERGER. Looking at it again in terms of where an employee and where a unit of government can put their money in order to help income security, there is going to be some substantial pressure on the system to provide for the adequacy of those pension systems, which is another problem for local government in America and for its employees. Do you agree with that?

Senator MURKOWSKI. The problem we have is that roughly one-fifth of our workforce is state government employees. The consequences of that, as it applies to this particular matter, and coupled with the fact that revenues are down about 40 percent—I think the estimate for five years is about $30 million, so it is significant.

But I think we addressed it last year adequately by having the phase-in, and that is the subject of my testimony. But I would agree with you in terms of the problems all over the place associated with inadequate funding. The problem is just how we are going to address this thing, I would think.

Mr. Chairman, I would ask if I might be excused.

The CHAIRMAN. Certainly, Senator Murkowski, and thank you very much.

Let me state to the members and to those in attendance here in this hearing that this is the first in a series of hearings and meetings on the budget for fiscal year 1988.

The Administration maintains that it has achieved the target under Gramm-Rudman of $108 billion. They say they meet that with receipts of $916 billion and outlays of $1 trillion. Now, that budget includes $22.4 billion in taxes and other revenue increases, and it calls on this committee to increase taxes by over $6 billion.

According to the preliminary estimates by the Congressional Budget Office, which is a nonpartisan or at least bipartisan office, the Administration budget does not meet that deficit target for fiscal 1988; and instead of the mandated $108 billion, CBO estimates the budget includes a deficit of between $135 billion and $140 billion.

So, even if Congress were to accept all of the Administration's proposals for spending cuts and tax increases—which isn't likely—we would still need to find an additional $27 billion to $32 billion in order to meet the target.

I would take this opportunity to ask the Administration to work with this committee, work with us in good faith to meet the deficit reduction goals of Gramm-Rudman-Hollings; because, without active cooperation between the Administration and the Congress, we just can't get the job done.

I also think it doesn't get us very far to say that the proposals in the budget aren't tax increases—which would be bad—but revenue increases—which are acceptable. The President recently told us that his proposed budget "cuts spending and leaves your family's paycheck alone." I am sure there are going to be some Americans who disagree with that statement, whether they are the state employee in Alaska or the schoolteacher back in Texas who contribute part of their wages to Medicare for the first time. Their paychecks will not be left alone. And the same holds true for coal mine operators who would face an increased bill for excise taxes, the state and local governments which would pay fuel excise taxes for the first time, and the list goes on.

I am not saying that the Administration's proposals shouldn't be enacted; I am only saying that, to the people who are affected, they are taxes.

Now, turning to today's hearings, our primary purpose is to find out exactly what the Administration proposes. We have a variety of odds and ends that have not been fully fleshed out in the budget documents. We are going to be hearing from the Administration witnesses today, and we will be scheduling public witnesses at a later time.

Now, as has been my practice, I would like to call on the ranking minority member who is here for any statement that he might want to make, and I would urge the rest of you, if you will, to put your statements in the record.

Senator CHAFEE. Thank you, Mr. Chairman. I have no statement and would defer to Senator Heinz, if he has one.

The CHAIRMAN. Senator Heinz?

Senator DURENBERGER. You just leaped. Would you split your time with me? [Laughter.]

Senator HEINZ. Thank you, Mr. Chairman.

I leap at the opportunity to make an opening statement, and I thank my friend Senator Chafee for not having one today; he is normally extremely articulate.

Senator CHAFEE. Is that a buzz word for "lengthy"? [Laughter.]

Senator HEINZ. And I do welcome this opportunity to comment briefly on some of these proposals.

Some of these proposals we have seen before; some are new. In the past we have accepted some; we have rejected some. I must say there are some in this passage that I was and remain strongly and evenly adamantly opposed to.

There is one new one, of course, which is the relatively extraordinary proposal to expand the employer share of Social Security to include all cash tips. Now, that is a new idea that I am strongly opposed to, because the Social Security tax is a payroll tax based on wages paid by the employer, not by someone else. And of course tips aren't paid by the employer, they are paid by the customer. I don't see how management can have any control over whether or when or how or to what degree a customer will pay a tip.

So, I think that there is no rationale or rational reason to justify that change.

I also note that the President has called for an increase in the coal excise taxes. There is a certain tragic irony in the proposal to reduce taxes on oil and increases the taxes on coal. The President is calling for a repeal of the windfall profits tax which presumably helps the oil industry. Why do we want to penalize the coal industry?

As I understand it, and we can get into this in the questions, it appears that what the Treasury is trying to do is dissolve the compromise we reached last year on this. And since that was a conclusion we reached after careful negotiation, I would oppose it on that basis alone.

But currently we are exporting some coal overseas. We have a very small cost advantage, and I don't think the Treasury Department has examined the effect of this proposal on making our coal uncompetitive or putting them at a serious disadvantage.

Thirdly, there is the proposal to treat black lung benefits paid to disabled coal miners as taxable income. It was proposed last year that workmen's comp and black lung be treated as taxable income, and that was overwhelmingly rejected. This time the Administration decided, "Well, we can't take on all of the workers; we will just take on some of them, the coal miners." Mr. Chairman, that is a selective repeal of the Tax Reform Bill.

Regarding railroad retirement, I understand there is an increased proposed for the payroll tax in that program. We have increased it from 15.5 percent of payroll to 19 percent of payroll and, if my numbers are correct, the Administration wants to increase it to a staggering 22 percent of payroll, in spite of the fact that the railroad retirement fund, according to my information, is now in good financial condition.

Lastly, I appreciate the Chairman's forbearance on the subject of the premium for the PBGC. I see Kathy Utgoff at the table. I think we are all aware that the PBGC is headed for some very serious financial problems, and that action is needed. But it would be a mistake if all we did was simply to increase the premium. We tripled it in the last Congress, and what we need is to look at the entire set of problems facing the PBGC and not just look at the revenue stream. The Administration may agree with that; I think they do.

So, Mr. Chairman, I thank you very much for this opportunity, and I hope my colleagues will consider these proposals very carefully and reject those, in particular, that we have rejected before.

Senator CHAFEE. Senator Heinz is going to listen carefully to the evidence and make up his mind after the hearing. [Laughter.]

Senator DURENBERGER. Mr. Chairman, may I have unanimous consent in this regard? [Laughter.]

The CHAIRMAN. Let me say, Senator Durenberger, instead of putting it in the record, if you want to make a short comment, why don't you go ahead?

Senator DURENBERGER. It will be short, and I will ask unanimous consent that the statement be in the record.

The CHAIRMAN. Good, because we don't have many witnesses, so it will not go on too long.

Senator DURENBERGER. I think it was fortunate that we yielded all the way down to John Heinz, because he said practically everything I wanted to say—with one exception, John. You did not point out the billions of dollars that we have saved through the alcohol fuel exemption. And again the Administration is here trying to undo that. I would just add that to your statement.

And my statement, Mr. Chairman, amplifies on my opposition to that recommendation.

I thank you very much.

The CHAIRMAN. As I say, Senator Durenberger, we will put your entire statement in the record, and I am sure it will be as eloquent as always.

Do you want to reconsider, Senator Mitchell?

Senator MITCHELL. No, thank you, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller?

Senator ROCKEFELLER. Mr. Chairman, I simply ask that my statement be put in the record, but there are a couple of comments I do want to make.

I share Senator Heinz's concern about not only the proposed increase in the excise tax on coal but also the effort to try to tax black lung benefits.

We went through an extraordinary, laborious process during the last Congress, working with the Secretary of Labor, which resulted in an agreement to increase the coal excise tax by 10 percent and reject the 50 percent increase. Now, at a time when we have a trade surplus in coal of $4.5 billion, and when the coal industry is flat on its back, the Administration is suggesting an increase in the tax that may be as high as 60%. In my view, this is absolutely out of the question.

We went through this last year. There was a bipartisan consensus to increase the excise tax on coal by 10 percent. And I must point out that this is not just a temporary tax, even though the law says so. The industry is willing to go ahead and pay the tax on a permanent basis so long as necessary. Our agreement will solve the black lung trust fund's deficit by the year 2014, and there shouldn't be any doubt about that. It is a fixed problem; everybody has agreed to it. Now to come in after less than a year and suggest that we do something entirely different to an industry which has lost, in my state, half of its employment, is incomprehensible. That is my first point, Mr. Chairman.

The second is with respect to the proposal to tax black lung benefits as income. It is beyond my understanding. First of all, the average black lung recipient in this country is making around $10,000 a year. That is just at the poverty level. And now the Administration wants to tax that benefit, which is something that people have earned. I should point out that black lung eligibility requirements are now so restrictive that only three percent of the coalminers who apply for black lung benefits qualify for them as opposed to 40 percent in the 1970's. To pick on these people, to select out coalminers with black lung—people who are poor, in bad health, and have high medical costs—and tax their benefits as income is something I do not understand. If its purpose is to make $180 million, then I say there must be a better way of doing it.

I would hope that this committee, Mr. Chairman, would reject out of hand not only this assault on the coalminer but also on the coal industry.

I thank the Chairman.

[The prepared statement of Senator Murkowski follows:]

Testimony By Senator Murkowski Before the Senate Finance Committee To Oppose Extended Mandatory Medicare Coverage To All State and Local Public Employees.

Members of the Senate Finance Committee:

I appreciate the opportunity to testify today in opposition to a proposal in the Administration's FY '88 budget that extends mandatory medicare hospital insurance coverage to all presently uncovered state and local public employees. If adopted, the proposal would require all state and local public employees to pay 1.45% of their first $43,200 in pre-tax wages for medicare hospital insurance. The proposal also would require state or local government employers to contribute a corresponding matching amount.

I am opposed to extended coverage for two primary reasons. First, it would create a substantial financial burden on state and local governments, especially those in already severely economically depressed areas. Second, it would place a new payroll tax on 4 to 5 million middle class working people.

A similar proposal to extend medicare hospital insurance coverage to all state and local public employees failed in last Session's Reconciliation Bill, and for good reason. It was untimely and unnecessary. We worked long and hard on the Tax Reform Act of 1986 to avoid new taxes on individuals. The President made it clear then that he opposed any new individual tax hikes.

Mandatory medicare coverage was also unnecessary last Session because our present law is adequate. Estimates show that state and local public employees turnover at an annual rate of 9%. Eventually all state and local public employees will be covered under medicare. Our Omnibus Reconciliation Act of last session extended mandatory medicare hospital insurance coverage only to those state and local public employees hired after March 31, 1986. This law now allows for a gradual phase-in of mandatory coverage, thereby making it easier for state and local governments to adjust to the substantial financial costs, accounting and program changes associated with mandatory coverage.

But, despite the good result we achieved last Session, we are asked once again to revisit mandatory medicare coverage that will impose great financial difficulty on state and local governments and individuals. We revisit this issue at a time when so many are experiencing extreme hardships caused by declining revenues and struggling to make ends meet. I also remind my friends on the Finance Committee, that we are revisiting this issue after the Congress denied revenue sharing to state and local governments.

One need only to look at a few examples to see the adverse impact of mandatory medicare coverage. The percentage of public employees that would be adversely affected in Illinois is 62%; California, 60%; Connecticut, 43%; Texas, 46%; Louisiana, 84%; and Minnesota, 32%, to name a few. Some predict that nearly 100% of the employees in Ohio and Massachusetts would be affected.

If Congress requires individual employees to contribute to mandatory coverage, we would be directly affecting the pocket books of a large number of our citizens. Consider that a $25,000 a year public employee would lose from his or her paycheck an additional $356 each year to pay for the medicare tax. This would easily offset any tax benefit given to that taxpayer under the Tax Reform Act of 1986.

I am particularly concerned at how the new proposal may tamper with or jeopardize the several alternative state and local medical benefit plans that successfully exist in many other states. Those state and local governments who have taken the initiative to set up their own plans would be penalized.

I am also concerned that this proposal would seriously affect those states that are experiencing serious economic downturns. For example, in my own home state, Alaska, where in just one year state revenues have dropped 40%, the additional cost of mandatory medicare coverage would be $30 to 40 million over a 5 year period. This says nothing of the cost impact on the several local governments in my state.

I understand why such a proposal is being offered: mandatory medicare payments pick up additional revenues and asks those who do not pay, but benefit from medicare, to pay.

But, Mr. Chairman, Congress worked out a good solution to mandatory medicare coverage last Session. Government employers and new employees would have to contribute to medicare after March 1, 1986. Therefore, Congress adopted a reasonable phase-in of mandatory coverage. This gives all concerned a good change to adjust.

I ask the Committee to reject the Administration's proposal, and to honor the solution that Congress adopted last Session.

The CHAIRMAN. Mr. Secretary, you are off to a great start. [Laughter.]

STATEMENT OF HON. ROGER MENTZ, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. MENTZ. Good morning, Mr. Chairman.

I just want to thank the members of this committee for their expressions of support. [Laughter.]

Mr. MENTZ. I think I heard one in there, just mildly at the beginning.

The CHAIRMAN. Let me say we are pleased to have you as our first witness from the Administration.

The Honorable Roger Mentz is the Assistant Secretary for Tax Policy for the Department of the Treasury, and we are very pleased to have Dr. Kathleen Utgoff, who is the Executive Director of the Pension Benefits Guaranty Corporation.

I understand, Mr. Secretary, you have a number of your experts to back you up, and we are delighted to have them appear at your call. Would you proceed with your testimony?

Mr. MENTZ. Thank you, Mr. Chairman. It is a special pleasure for me to be here before the Finance Committee this morning. I would like to discuss and take questions on the $6.1 billion of the Administration's proposals that are revenue raisers in the President's budget.

Let me say at the outset that it is extremely important that we not undo any of the dramatic and important tax reforms that were accomplished last year. The President feels very strongly that any increase in tax rates or any new tax of a general application would be a breach of the understanding that was reached last year, the commitment made to the American people to broaden the tax base in exchange for which the rates would be lower. I think it would be really unfair if, having broadened the base and gotten rid of a lot of the special provisions, the rates were then pushed back up again. I know there are many on this committee who share that view and certainly the President feels it very strongly. I am just saying that at the outset.

I would try to move fairly rapidly through these proposals and then, when the others are finished, take questions.

On the extension of Medicare to state and local government employees: Medicare presently applies to employees hired after March 31, 1986. It applies to employees previously hired only if there is an agreement—in other words, only if the state elects. The proposal would be to extend the Medicare coverage to all state and local employees; in other words, pick up those who were hired before April 1, 1986, as well as those hired after.

The Medicare tax is 2.9 percent, shared equally by the employer and the employee, and this is a large revenue item. There is now $1.6 billion involved for fiscal 1988 and that is a short period, because the tax would only apply beginning January 1; therefore, for future years the revenue pickup would be more than that.

On the question about cash tips being included for the employers' share of Social Security taxes: With all due respect, I think that proposal is essentially correct, and I would like to explain it in perhaps a little bit in more detail than I might otherwise, because of Senator Heinz's comments at the outset.

The way tips work under current law for income tax purposes, is that the employee reports—files a statement with the employer—and discloses how much he or she received in tips. Those tips are treated as taxable income, and there is employer wage-withholding—in other words, regular income tax withholding applies, and it applies to every dollar of those tips.

Furthermore, the employee's portion of Social Security tax applies to all of those tips up to the Social Security base.

Really, it is a quirk in the law that the same parallel treatment does not apply to the employer's portion. The employer's portion only applies up to the minimum wage. So if the employer is paying the employee less than the minimum wage, and he gets tips in excess of the minimum wage, the difference between what is paid up to the minimum wage is the amount of tips on which the employer FICA tax is withheld.

It doesn't really make any sense. You have got employee FICA taxed on the full amount, and not the employer. So I think the problem here is just that the proposal is really not all that well understood. I think, conceptually, the proposal is dead right; it simply is proposing that the employer and employee portion of FICA tax be the same, which of course it is in every other case. There is about a $200 million revenue impact in Fiscal 1988 on that.

On extending Social Security coverage to a variety of situations: These proposals are based in part on revenue and in part to broaden the coverage.

The first one, covering Armed Forces Reservists, is primarily revenue; it is $200 million. That would cover about 1.4 million Reservists for salaries paid for their inactive duty earnings—that basically means weekend drill sessions. They are already covered when they go away for two weeks active duty, but they are not covered for this so-called "inactive duty." That is a $200 million pickup. It seems like it is clearly appropriate.

For students: There is an exception for students where they perform services in an academic setting. If that is changed and students were subject to FICA, that would be a $60 million revenue pickup. It would also cover students where in today's world you have some older students and where FICA/Social Security covers more than just retirement income but disability and other benefits, there is a coverage aspect to that proposal as well.

The rest are all basically coverage; there is no significant revenue in the agricultural workers or the children or the spouses.

For agricultural workers, the concept would be that any employer who pays more than $2,500 in wages would be required to cover all agricultural employees, even if they don't meet the current law standards. There is $4 million in revenue, obviously not a revenue concept; but the idea would be to cover the migrant farm workers with Social Security.

For individuals aged 18 to 21, and for spouses, the concept here would be that payment of wages to these persons by the employer in his trade or business would be subject to FICA. Not, however, if a child over 18 is getting some sort of allowance for taking out the garbage; that is not paid in the parents' trade or business, so that would not be covered. But if the parents are themselves engaged in a business and pay their daughter or son, the idea would be that that person would be subject to FICA the same as everybody else. Again, it is a coverage point; there is not very much revenue in it.

Next, on group term life insurance, there is a provision in the existing law that completely exempts group term life insurance fringe benefits from FICA. That is inconsistent with the income tax law where the first $50,000 of group life is excluded, and over that it is a taxable fringe benefit. And indeed, it is all taxable to a high-paid employee if the nondiscrimination rules are not satisfied.

The thought would be to conform the FICA to the income tax here; it is about $43 million in revenue pickup.

Gasoline and other highway excise taxes: The concept there is that the Highway Trust Fund is basically a fund that is organized to provide federal assistance for highways and mass transit, and it is funded basically by these excise taxes which are, in effect, highway user fees. They are excise taxes on gasoline, diesel fuel, tires, heavy trucks, and so forth. The Administration's proposal is that if it is a user fee it ought to be applied to every user, and that there shouldn't be exceptions for state and local or public or private bus operators, or any of the other exceptions. The notion is that a school bus tears up the road just as much as I do when I drive my Mazarati. [Laughter.]

Mr. **Mentz**. I thought I would make a populist argument there. [Laughter.]

Mr. **Mentz**. That involves $.6 billion, so there is a fair amount of revenue in that.

On the excise tax on coal production and the black lung replacement income: The problem there is that the Black Lung Disability Trust Fund has had chronic financial problems. It is $2.9 billion in debt right now, even though the Federal Government has assumed responsibility through the General Fund for paying $1 billion a year in income replacement benefits for some miners. In other words, it is supposed to be—there will be a Labor Department person who is a lot more familiar with this than I to answer questions, but just to give you the broad picture, the fund would ultimately turn into the black under this arrangement, whereby a billion dollars a year is being effectively paid out of the General Fund, and that wasn't the original notion of the way the Black Lung Fund was supposed to work.

Also, the General Fund is bearing the interest costs. The Black Lung Fund borrows from the General Fund, and the interest is being paid, in effect, by all taxpayers. The Administration feels that is not appropriate.

The increase in taxes proposed for underground mines would increase the tax for coal from $1.10 to $1.70 per ton; for surface mines, the 55 cents we propose to increase to 85 cents per ton. The cap as a percentage of sale price would increase from 4.4 to 6.8 percent.

On the replacement income, the proposal would tax the portion of black lung benefits that are a replacement for income. This is consistent with what was done in tax reform for unemployment benefits. And the notion that was discussed and debated last year is that, with a revised income tax structure, a former coalminer who has got black lung benefits who is earning $10,000, as Senator Rockefeller postulated, under the new tax law would be just about at the poverty level and would not pay tax.

So, we have a revised tax law that provides much more relief for the lower-income people; but, if there happened to be, and I am sure there are some, black lung trust fund beneficiaries who are a little bit better off, the notion is a cash payment to them is really not any different from any other cash payment; it is income replacement and ought to be subject to tax.

From a tax policy standpoint, I think other items that are income replacement fall into the same category; although, admittedly, last year we did not—we deliberately did not—choose to tax black lung benefits. There is no question that that was a decision and a very conscious decision of Congress. The Administration recognizes that in making this proposal.

On the Rail Industry Pension Fund, the proposal there is to increase the Tier II tax and also subject rail employment to federal and state unemployment insurance. The increase on the railroad retirement future tax would be 1.5 percent effective January 1, 1988, and 1.5 percent January 1, 1989. That would be shared by the employer and the employee, and the railroad retirement workers would be covered by unemployment insurance beginning, with transitional coverage, on October 1, 1987.

There is a fair amount of revenue in those. There is $0.1 billion for the Tier II tax, and $0.1 billion for the unemployment insurance.

Repeal of the windfall profit tax: As you all know, in 1980 there was enacted the windfall profit tax, which is an excise tax on domestically produced crude oil, classified in three different tiers. The Administration proposes to repeal it.

The tax was imposed when the price of oil was decontrolled and the Congress' concern was there would be a so-called "windfall" when domestic prices rose to the world market. And that windfall was considered to be the subject of a separate tax. But as we all know—and you know, Mr. Chairman, very painfully—the price of oil has come way down. It was well below the point where any windfall profit tax would apply. And indeed, even today at a price of $18, we are collecting virtually no windfall profit tax. It is, nevertheless, a severe administrative burden, primarily for the independent oil operators; although, it is also a burden for the IRS.

Even if the price of oil were to increase from here on out—and indeed, we hope that it does somewhat—if it does, that would not be the windfall that was sought to be taxed. If the price of oil increases, it is no different than if the price of gold or lead or any other commodity increases; it is simply a market fluctuation, not the windfall that was targeted by the tax. So, in the Administration's view it is appropriate to repeal the windfall profit tax.

Under our estimates, which are based on OMB assumptions, there is no material revenue impact of the repeal of that tax.

Moving to the Customs User Fee, last year there was enacted an ad valorem user fee on imports. It is scheduled to expire on September 30, 1989. It does not apply to imports with U.S. components or imports of items that contain a U.S. component.

The proposal would be to apply the fees indefinitely and to apply them to all products, including those imports with a U.S. component. There is about $0.1 billion in that proposal.

Mr. Chairman, that is kind of a quick-and-dirty overview of the Administration's—wait a minute, I am missing one here.

There is also a proposal on the Bureau of Alcohol, Tobacco and Firearms, which is basically a user fee fundamentally applicable to licensing and permit fees for manufacturers of firearms, and similar fees for producers, processors, and retailers of alcohol and tobacco. That would bring in about $50 million.

Clearly the largest of the proposals in the Administration's budget would be an increase in Internal Revenue Service funding, which would be used to provide a number of additional employees of the Internal Revenue Service. That is expected to raise about $2.4 billion for Fiscal 1988, and I believe that Commissioner Gibbs, who is much more knowledgeable on the details of how that would work will be testifying to this committee at another time.

Mr. Chairman, that concludes my prepared remarks. I will be glad to answer questions after Kathy completes her remarks.

The CHAIRMAN. Thank you very much, Mr. Secretary.

I really have trouble with the notion of raising user taxes for the purpose of cutting back on the deficit. I look at the situation with these budget proposals, for example, where you are proposing increases in the Social Security taxes without any change in the Social Security program, as I understand it. And to the best of my knowledge, after what we did not long ago in the Social Security program, it is well funded.

I also look at the situation on highway taxes. You talked about it being a user tax. So, you are talking about more income from a highway tax; yet, I don't see any expansion of the highway program that the Administration is coming up with.

I would like it if you, with your tax policy hat on, would comment on this idea of raising user taxes for the purposes of affecting the deficit in the budget.

Mr. MENTZ. Well, I think the notion of the Administration here is that in some areas—and I will take the tip case, because I think that is the clearest—the Social Security tax in that case, there is a glitch in it; there is a hole where it is not working correctly. The employee is paying his share, but the employer is not. And the effect of straightening it out and making it right will be for Fiscal 1988 to improve the deficit, bring it closer to the $108 billion.

Now, admittedly, for Fiscal 1988 that particular fund is well-funded, so it is not correct to say that that brings that fund up to solvency where it isn't solvent already. But I think down the road it does, and down the road there may be times when, if the fund continues in the solvent state and we get our other fiscal house in order, the theoretical answer is, "Well, then, once you bring the system up so that it is fair and working exactly right for everybody, then, if you have too much money in that fund, maybe you can reduce the rates." Obviously we can't reduce them now for everyone because of the budget straits we are in, but I believe that is the notion.

The CHAIRMAN. Right there you say you can't reduce it now because of the budget straits that we are in, not because of an inadequacy of money going into the Social Security Fund. So, there is no longer a direct correlation, it seems to me, between the benefits and the tax, and that is what is worrying me on some of these other user taxes.

Well, let me say, for purposes of understanding by the members here, we will limit the questioning to seven minutes, and then we can go back to another round of questions if members desire.

I have a question about your proposals on railroad unemployment and retirement. In making your proposals, have you consulted with the members of the Railroad Retirement Board? Do they endorse your proposals?

Mr. MENTZ. I don't believe so. I don't believe we have consulted them. I have not personally consulted them.

The CHAIRMAN. It is my understanding that you have not consulted with them, and it is also my understanding that neither railroad labor nor management shares your view that the railroad retirement system should be abandoned in favor of covering rail workers under the regular federal/state unemployment programs.

Now, since the railroads are ultimately going to bear the costs of the program, why shouldn't we keep it?

Mr. MENTZ. I guess the argument is just that—

The CHAIRMAN. He has obviously spent a lot of time thinking that one out. [Laughter.]

Mr. MENTZ. I am going to need more time to give you a good answer on that, Senator. Let me get back to you on that, if you don't mind.

The CHAIRMAN. All right.

Now, in your past budget proposals the Administration has talked about doing away with some of the exemptions on the highway excise tax; but you've left alone the exemption for state and local government—and you touched on that in the comments you were making. Isn't what you are doing really just transfering some of the federal deficit over to the state and local governments as you now propose to remove their exemption?

Mr. MENTZ. That may be a collateral consequence of it, Mr. Chairman, but I think the theoretical justification is the one that I expressed, that the Highway Trust Fund is basically designed to realize some revenue from the users of the highways and to plow it back into the roads and keep them in repair and continue to build more roads.

I think the Administration's position is that it ought to apply to everybody—no exemptions, no special provisions.

I recognize full well that the job of Congress is to make distinctions and to weigh and balance where certain situations are more meritorious than others, and certainly that is the process we went through at great length last year, and I wouldn't be surprised if it happened again.

The CHAIRMAN. Mr. Secretary, in all candor, it looks to me like what you have chosen are certain objectives insofar as trying to reduce the deficit without a great correlation of user tax receipts and the utilization of the corresponding program. I think you have chosen that as an objective. You have picked yourself out some numbers, and then you have gone back to try to justify it. And concerning the question I asked you on the railroad issues, you had not yet arrived at a justification. I will be looking forward to reading what you have to say later in your written statement in that regard.

I would like a clarification on the proposal of the two-year extension of the taxes which fund the Airway Trust Fund. It is my understanding there are no changes other than the expiration date.

Now, when we reauthorized that fund in 1982, we accepted the Administration's estimates that the tax would raise the amount of money needed in the fund. At the end of Fiscal 1982 it had a $2.1 billion surplus, and I understand at the end of Fiscal 1987 it will have approximately $5 billion. So what I am trying to find out: Is all that money needed? Is it going to be used?

I hear all of these stories about the near-misses of aircraft, about the lack of modernization of airports; yet, I see no direction on the part of the Administration to try to resolve some of these problems in the utilization of these funds. Could you give me some comment on that? Are we just going to continue to build a surplus there, to try to affect the numbers on the deficit overall?

Mr. Mentz. Well, it is really the same point that you made earlier on the Social Security Fund. To the extent that a fund isn't using all of its revenue, it effectively benefits the Gramm-Rudman target for Fiscal 1988. But that is not the way the proposal is conceived, and, again, this is not strictly in my jurisdiction, Mr. Chairman, but my understanding is that this is a responsible proposal conceived by the Department of Transportation.

If you want more on it, I would be pleased to get that for you.

The Chairman. I would like that.

Mr. Mentz. I would be glad to.

The Chairman. All right.

The other one that concerns me: This committee last year imposed a user fee for Customs on entry of goods, and that amount of money was supposed to go into a dedicated fund for the Customs Service. As I look at the Administration's budget, I don't see any request for any appropriation out of that fund that the Congress set up. Are you not planning to tap that fund, to fund any of the Customs Service? I am deeply concerned about it, because what I see in the way of the proposed cuts in the Customs Service. I'm concerned about what the cuts will do for drug interdiction, what they'll do in delaying the transport of goods across the border, and how they will affect trade on both sides.

Mr. Mentz. It is my understanding that the concept—and I will turn it over to our Customs expert in a second—my understanding is this is part of the Reconciliation Bill last fall, I believe. The idea was that the amount of revenue was determined so that it exactly fit with how much was to be spent or used by the Customs Service in administering its program. And that is still what is contemplated.

The recommendation there is that the fee be continued beyond September of 1989 and that it apply to all imports. But perhaps you could articulate further on that.

The Chairman. There is no question but what it was anticipated that we would finally get a zero balance in that situation. That is what we were suggesting. But if you are not planning to use the fees this fiscal year, are you planning to scale back that fee in the next two years? Or what kind of an offset are you talking about?

Mr. **Simpson**. Mr. Chairman, I am John Simpson. I am Deputy Assistant Secretary for Trade and Tariff Enforcement.

There is no request in the budget as yet for an appropriation from that fee. All monies deposited in that fee do have to be appropriated by the Congress, and there is not a request yet. It is our expectation that the funds deposited in that fee will be appropriated by the Congress and used to provide a level of service, a standard of service, acceptable to the public for commercial services provided by the Customs Service.

The **Chairman**. I see my time has expired. I now defer to the Senator from Missouri, Senator Danforth, for questions.

Senator **Danforth**. Mr. Secretary, with respect to the tax bill that we have for 1986, the Treasury has estimated that it will not be revenue neutral but that it will lose about $15 billion over the five-year period as it stands, and a good part of that loss is from the ESOPs provision. Does the Administration have any suggestions on how that could be fixed, or if it should be fixed? Would you explain just briefly what it is? What is the problem, and what should be done about it?

Mr. **Mentz**. I would be glad to, Senator Danforth.

The provision in the 1986 Act dealing with ESOPs permits an estate to sell stock to a an employee stock ownership plan and take an estate tax deduction for half of the gross proceeds of the stock sold. That was budgeted in the Tax Reform Act at I believe $300 million. It contains no holding period requirements so that, read literally, if a person dies, his estate, if properly advised, could purchase stock, sell it to an ESOP and take an estate tax deduction for half of the amount sold. That has the potential for dramatically reducing the estate tax revenue.

In fact, if it were to be read exactly literally, the potential over a five-year budget period would be a $20 billion loss.

In early January, the Internal Revenue Service put out a statement saying that it is required that the decedent own the stock on the date of death. That is not explicitly in the statute; nevertheless, the position was put out by the IRS.

Some have said that they would challenge that as going beyond the legislative language and committee report. We think it is a reasonable interpretation of the statute. But even with that interpretation, even if a decedent must own the stock on the date of death, there is still a $7 billion estate tax cost over the five years. So it is still a serious problem. It is the largest contributor to the $15 billion shortfall.

Senator **Danforth**. Should it be amended?

Mr. **Mentz**. Yes, I think it should. First of all, in Treasury I think we have gone as far as we can. Clearly, there should be a requirement that the stock be held by the decedent on the date of death. But even that isn't fully adequate, because for someone who is on his deathbed, it is like a flower bond; you could go out and buy the stock, and I suppose you could even leverage it, and for a relatively modest investment you could get a tremendous amount of gross proceeds.

So I think, clearly, even a greater holding period than just at the date of death needs to be imposed. Even that is going to cost us money beyond the $300 million. I don't think you could get back the $300 million unless you cut it off today.

Senator DANFORTH. Will Treasury be making a proposal to deal with that problem?

Mr. MENTZ. Yes. We have already been working with staff, and, Mr. Chairman, you and I have discussed it.

The CHAIRMAN. That is right. And I would say, Senator, it a concern, one that is well-expressed, and one that we obviously have to address in a hurry. It has not been anticipated at all, and we received some very erroneous numbers that we acted on, obviously.

Senator DANFORTH. Could we also entertain briefly the subject of the R&D credit that Secretary Baker is going to be making suggestions on later to the Ways and Means Committee?

Mr. MENTZ. Well, Secretary Baker will be addressing both the R&D credit and the allocation of research and development expense to foreign income in testimony that he will be making next week to the Ways and Means Committee, and that is on the competitiveness initiative of the President. I believe he will be testifying before the Senate Finance Committee on that subject as well.

Let me just make one comment on that. I was asked about it yesterday by the Chairman of the Ways and Means Committee, and I responded that we were working on both of those subjects and particularly on the allocation of the expense. We are mindful of the revenue costs, and ideally it would be a worthy objective to try to make it revenue-neutral. Obviously you can't make that one proposal revenue-neutral, because all you need to do is extend what happened in the Tax Reform Act: 50 percent allocation to U.S. income and the balance to be determined under the regulations. All you have to do is extend that a month beyond the August 1987 cutoff, and you have lost revenue. So, clearly, that proposal in and of itself cannot be revenue-neutral.

What we were thinking was, maybe it could be combined with some other proposal or proposals, and at least get it in the direction of revenue-neutrality. But is is impossible to make that one proposal revenue-neutral and do anything other than current law.

Senator DANFORTH. Well, if we are going to fix the ESOPs proposal and if we are going to do anything for R&D, we are going to have to——

Mr. MENTZ. Well, I think we are clearly going to have a technical corrections bill, which may be a vehicle that would be available for—I think the ESOP really is something that was a mistake. As you say, you acted on numbers that turned out to be wrong. I might say that Treasury as well missed that point. We were looking at it as a $200 to 300 million item as well.

I think there is going to be and I hope there is going to be a revenue bill and one that perhaps moves quickly.

Senator DANFORTH. How about the inclusion of yachts and second homes for the purposes of mortgage deductions? Do you think we should allow somebody to deduct interest payments on a yacht when a young person cannot deduct interest payments on a car, for instance?

Mr. MENTZ. I think it was deliberately considered. If you ask me do I think it is the right tax policy, I would say I think there is probably a question about it. But I don't think it was inadvertent the way the ESOP provision was, and I think it is built into the revenue numbers on the interest.

Senator DANFORTH. Would you object to the inclusion of that little item on this technical corrections list?

Mr. MENTZ. I certainly wouldn't.

The CHAIRMAN. Let me just interpose there that there is no question but what that is an enormous loophole, and that we have to act on it.

I know you discussed it with me, and we want to move as quickly as we can. I am sure that the original proponent of that piece of legislation did not intend that kind of a result at all. I am sure he didn't. I know you have been discussing it with the Chairman of the Ways and Means Committee, so it has to be addressed. And from the standpoint of the Chairman, we will address it as early as we possibly can.

Senator Baucus.

Senator BAUCUS. Thank you very much, Mr. Chairman.

Secretary Mentz, I joined with Senator Wallop and others, as well as Senator Danforth, in introducing legislation to make the R&D tax credits permanent. In fact, our bill raises the level, as you may know, to 25 percent.

I also plan to cosponsor Senator Wallops proposal to find a permanent solution, too, for the R&D allocation problem. It is my very strongly held view that the present rules that a company has to operate under, requiring greater allocation of R&D offshore, virtually forces companies to do a lot more of their R&D offshore and hurts our competitive position.

I wonder what other measures the Treasury might be interested in in the Technical Corrections Bill to help pay for restoring some American competitiveness with R&D tax credit, for one, and section 861 on the other. In addition to ESOPs—that will give us a little revenue—and perhaps the yachts and second homes which might give us a little revenue, what are some other items as far as Treasury is concerned that could be in a technical corrections bill?

Mr. MENTZ. Well, Senator Baucus——

Senator BAUCUS. Say if we need some revenue to help pay for some of this.

Mr. MENTZ. In terms of technical corrections, my staff has been working with the staff of the Senate Finance Committee, staff of the Ways and Means Committee and the Joint Committee staff. Most of the technical corrections that are coming up and are being worked into the Technical Corrections Bill are truly technical and do not result in revenue raises.

Now, I think it is fair to say that Treasury always has a list of potential revenue-raisers. We got pretty low on that list toward the end of last year, as I am sure you will recall. But in terms of specifics, I have to go back and take a hard look at it and really consult with you all as to what you may want to do.

I think in that respect, particularly talking about 861-8, the allocation of expense, really what you are talking about there are companies who are in an excess foreign tax credit limitation; in other words, they are using every dollar, and they have more foreign tax credits than they can use.

I don't think what we should be trying to do, if you want to help them, is do something liberal on the R&D allocation but tighten some other rule in the international area, particularly in the foreign tax credit area, to make it up that way. It seems to me you are giving with one hand and taking away with the other for the same basic industries and companies that you are trying to deal with.

So I think we have to kind of look broader than that, and it is not easy. It is not easy to come up with the kind of money that is involved.

To give you an idea—I don't recall the numbers on the R&D credit, but for the allocation of expenses—if you were to extend current law, in other words just extend the 50 percent allocation, allocation of domestic and the rest allocated in accordance with existing Treasury regulations, over the budget period that is about $2.2 billion in the Treasury's estimate. Obviously, anything more than that in terms of a higher percentage gives you a greater revenue cost.

So, it is a serious problem. I think the Administration is sympathetic with the approach that you and Senator Danforth and Senator Wallop and others have got in mind. We would like to try to work with you on that, but finding the revenue is not going to be easy.

Senator BAUCUS. In addition to paying for the R&D tax credit and section 861, it seems to me that there is additional pressure for Treasury to come up with ideas for revenue raisers in some sense, because in passing our budget resolution here, we have to go by the CBO figures. As you well know, the CBO thinks we are $30 billion further short of Gramm-Rudman. And if the Administration doesn't have $30 billion of additional cuts, it seems to me we have to have $30 billion of additional revenue, or some combination of cuts and revenue.

So, the reality seems to be that the Administration will have to come up in the Report to the Congress, anyway, with some additional areas of raising revenue.

Mr. MENTZ. Well, the Chairman in his introductory remarks asked the Administration to work with this committee in good faith, and I assure you that Treasury is prepared to do that.

You may have seen Dr. Miller in his remarks to the Ways and Means Committee yesterday. He said that he thought maybe there were other areas in which to pick up some more revenue. I think that is significant. I would tell you that I think you know that I and my staff would be prepared to work with this committee.

But obviously, revenue is going to be a very important constraint.

The CHAIRMAN. Thank you very much.

Senator Chafee.

Senator CHAFEE. Thank you very much, Mr. Chairman.

Let me address first the black lung situation for a moment. I think somebody ought to write a case history of the irresponsibility of Congress and indeed the Administration at that time. I happened to be on the Labor and Human Resources Committee at that time," in about 1977 or 1978, when the so-called "corrections to the black lung program" took place. The Administration remained completely silent as the Committee and subsequently the Congress as a whole, and more particularly the House, went hog-wild with that program. The House instituted such so-called "reforms" as forbidding the Federal Government to have a chance to Re-read the x-rays of a person who claimed to have black lung because a person from the Federal Government might find that the applicant didn't have black lung: therefore, under the so-called "reforms" you would have to take it on say of the applicant's doctor. I can't believe that there wasn't all kinds of doctor-shopping as a result.

So, finally it came down to anybody who had ever seen a coal mine was entitled to receive benefits under the program. And of course, it went hog-wild; the costs of the program far exeeded any estimates. In 1981, to the credit of the Reagan Administration, corrections were made, and the program was strapped down so that those who were truly entitled received the benefits, and those who weren't no longer could. The problem was, the horse was out of the barn. It is a shocking example of irresponsibility on the part of Congress.

And like most things, there are no fingerprints; there is no responsibility tracing, accountability on how it happened.

I can remember the debates on the floor of the Senate. Actually, we at least had a vote on permitting the Government to re-read the x-rays; but that was defeated. So now we are in this situation where the program is costing—what is it costing the Federal Government now? Over a billion dollars over and above the taxes which are contributed to the fund? A billion dollars a year?

Mr. MENTZ. That is right.

Senator CHAFEE. And at the time the program was created it was going to cost, you know, something like $400 million, which was going to be covered by the increased taxes on coal. Now I don't know how we are going to get out of it.

Turning to another issue Mr. Chairman, I think that from this committee must address the mistake that was made regarding ESOPs. As I recall it, Senator Long had a provision on ESOPs which was supposed to cost something like $300 million.

As I understand it, what happened was that the ESOP provision which was written up and passed was far broader than Senator Long or anyone on this committee intended. That is where you get into the $7 billion deficit problem. I would hope that not only would we correct this mistake, but that we would correct it retroactively, right back to the date that we passed it. Whoever took advantage of this knew they were getting something for nothing. I cannot believe that there weren't a lot of high-priced lawyers called in who said, "Here's a loophole; let's rush through it."

How long is it since the Tax Act went into effect? How many months?

Mr. MENTZ. Well, this provision just went into effect January 1st, and on January 5th the Treasury announcement came out that you had to hold a stock on the date of death.

I think your idea of going back to January 1st or at least January 5th is fully supportable.

Senator **Chafee**. Well, I would go right back to January 1st, with fair warning from the committee today that any lawyer advising any estate does so at his own risk, because it is our intention to go back and make it as we originally intended it, whatever that was. I must say I wasn't exactly clear on what we tried to do. The whole thing was a mystery to me; but, if we kept Senator Long happy for $300 million, I thought it was a bargain. [Laughter.]

Senator **Chafee**. So, Mr. Chairman, speaking for one Senator on this committee, I will do all I can to make it retroactive. And if somebody wants to advise their clients to do some fancy footwork and get out of this thing, they do it at their own risk.

Finally, Mr. Chairman, the Technical Corrections Bill, as I understand it, deals with technical corrections and not with revisions of the Internal Revenue Code as it has always been.

Now, coming from the largest boat building state in the country, where as you know we don't call them "yachts" but call them "boats," I want to make it clear that this provision which allows a deduction for interest on boats which qualify as second homes has always been in there. That wasn't something we did last year. That wasn't somebody racing through a loophole. A boat that you live on i.e. one with a galley and a head and so forth has always been considered a residence, isn't that right, Mr. Mentz?

Mr. **Mentz**. Yes. It is considered a residence for the reinvestment of the proceeds. If you sell a residence, you can defer the gain. If you reinvest in a boat, that is your principal residence. That is correct.

Senator **Chafee**. Right. So that this isn't some scandalous thing. Indeed, perhaps it should be encouraged. [Laughter.]

Senator **Chafee**. What we are doing, as a matter of fact, Mr. Chairman, we are just gobbling up so much excellent land in this country for homebuilding that, if there are those who prefer to live onboard a boat, humble though it might be, as their residence, that is laudable in my judgement.

So, Mr. Chairman, the suggestion that this is something we ought to correct is something I do not concur with.

The **Chairman**. So the boat people have been heard from.

I understand your concern, Senator. I must say, insofar as ESOP goes, I frankly normally abhor retroactivity in tax law. But this is such an obvious mistake on the part of Treasury and the Congress that I think any attorney ought to understand that he is doing the high-risk job of advising his client if he tries to rush through that. Senator Bradley.

Senator **Bradley**. Thank you very much, Mr. Chairman. Senator Chafee's line of questioning leads me to perhaps ask, if there was a boat that was a large boat in which apartments were rented, and the water underneath was rented, would that water rent be considered passive income? [Laughter.]

Senator **Bradley**. But I won't ask that question right now.

I want to simply echo what Senator Danforth and Senator Chafee and the Chairman have said about the ESOP provision. Joint Tax estimated it as a $300 million loss, and it became what?

Mr. **Mentz**. Well, if it were read so that there was no holding period required, it would be a $20 billion loss. Assuming that the decedent must hold the stock on the date of death, which is the position put out by the Internal Revenue Service on January the 5th, it is still a $7 billion loss.

Senator BRADLEY. Now, the budget assumes a $7 billion loss?

Mr. MENTZ. That is right.

Senator BRADLEY. So, if this loophole was closed, we would reduce the budget deficit by $7 billion?

Mr. MENTZ. That is right. Wait a minute—the $7 billion is over five years.

Senator BRADLEY. So, over five years it would be a $7 billion budgetary saving.

Mr. MENTZ. Right.

Senator BRADLEY. We would reduce it over five years by $7 billion.

Mr. MENTZ. Yes. We would pick up maybe a little more than a billion in Fiscal 1988.

Senator BRADLEY. And who benefits from this particular provision?

Mr. MENTZ. Well, any estate that is subject to federal estate tax, which generally means an estate of around $600,000 or greater. And certainly the ones that would benefit would be the ones that would be substantially greater.

Senator BRADLEY. What percent of the decedents would you say pay estate tax?

Mr. MENTZ. It is very infinitessimal, very small.

Senator BRADLEY. So it is about maybe even less than one percent.

The CHAIRMAN. May I interrupt for just a moment? We have a vote in process, and Senator Chafee and I will go make that vote, if you want to continue, and we will be back. Why don't you continue?

Mr. MENTZ. And there will be further questions, Mr. Chairman?

The CHAIRMAN. Oh, yes.

Senator BRADLEY. I will be just another minute, and then I will pass it to you, Dr. Utgoff.

So, Mr. Mentz, you are saying that this is a loophole that benefits maybe less than one percent of the population, with estates of more than $6-700,000. And by closing it we would cut the budget deficit over five years by $7 billion?

Mr. MENTZ. Precisely.

Senator BRADLEY. Well, let me just underline what everyone else has said. If there are information waves that go out from here, my guess is that this is going to be a candidate for closure and will be closed, and lawyers ought to know that and advise their clients of that.

Now, is there any way to do it so you would only leave it at $300 million, which was the assumption of the committee?

Mr. MENTZ. We certainly want to look at that and we are looking at that, but the way to do it is to look at the holding period requirements. You know, maybe impose a year's holding period, that sort of thing.

Senator BRADLEY. But the safest thing to ensure that we don't have to come back and visit this issue is just simply to close it, thereby leaving in the bill only five ESOP provisions instead of six?

Mr. MENTZ. Do you mean eliminate the provision?

Senator BRADLEY. Yes.

Mr. MENTZ. That would do it.

Senator BRADLEY. You would do it?

Mr. MENTZ. That would do it. [Laughter.]

Senator BRADLEY. Does Treasury have a position on this issue?

Mr. MENTZ. I think we are in agreement with you, the Chairman, and other members of the committee: we have got to do something about this provision. Cutting it off and making it only available for—I don't know, five days, or 30 days, or whatever—certainly would be effective to absolutely limit it to whatever the dollar loss is. It is not the only way of doing it, and I think we need to look at options, but, yes, Treasury is supportive.

Senator BRADLEY. So if the committee did that, Treasury would support it fully? Recognizing that a mistake was made.

Mr. MEOTZ. Assuming that that comes to the $300 million and that was the original intent, yes.

Senator BRADLEY. Or less. Oh, I understand—because of the date problem it was limited?

Mr. MENTZ. Yes. Where we would want to be would be to respect Senator Long's intent to the extent we can within the revenue assumption fo the $300 million.

Senator BRADLEY. Fine. Thank you very much. I think that is a message echoing through the hearing room, and you have only amplified it.

Senator Rockefeller.

Senator ROCKEFELLER. Secretary Mentz, your proposed 60 percent increase in the coal excise tax, in my judgment, is not needed to correct the problem, and I want to understand why you feel it is needed.

Mr. WOOD. Senator Rockefeller, I am Bruce Wood. I am the Associate Deputy Undersecretary for Congressional Affairs, and to my right is James DeMarce, who is the Director of the Black Lung Program.

The reason why the tax increase is necessary is because, under the current tax scheme, the trust fund will never be solvent. When Congress last year increased the tax 10 percent in the Reconciliation Bill, that 10-percent increase was made to expire at the end of Fiscal 1996. It was not a permanent increase in the excise tax, as certainly we understood it was to be. So, even with the five-year forgiveness extension which the Congress also incorporated in the Reconciliation Bill, the trust fund will not be solvent unless there is a further tax increase.

Senator ROCKEFELLER. I have to say I fundamentally disagree with that. First of all, I think that it is looked upon by the industry as a permanent tax.

Secondly, I understand, obviously, that the debt has increased for the Black Lung Trust Fund in this past year, but there is a reason for that. The reason is that the fund is still paying out benefits for the people who qualified in the late 1970's under the more liberal eligibility criteria.

I know of, and have heard of, no evidence which is compelling or convincing that the agreement which was reached last year, in a bipartisan fashion, with hard work, will not bring this Trust Fund into solvency by the year 2014.

In 1981, as you recall, the coal excise tax was doubled, and then increased by 10 percent last year. And now the Reagan Administration is suggesting another increase. Coal today is sold on the spot market. That was not necessarily the case in the late 1970's or early 1980's. Price is of paramount importance to whether or not coal gets sold. Since 1981 we have lost close to half the coal mines in the country. Coal exports, which are still on the positive side, amounting to a $4.5 billion trade surplus, have declined by 24 percent since 1981.

I want to know how you think you can do this to an industry, as I indicated earlier, which is flat on its back. For underground coal, your proposal means adding 66 to 70 cents to the price per ton. In a spot market arena, where coal is being beaten up by competition from the Chinese, the Russians, the Australians, the South Africans, the Colombians and the Canadians. In raising this $400 million of revenue for the trust fund, aren't you in fact going to inflict much more damage on the economy of this country?

Mr. WOOD. Senator, let me just say that the 60 percent increase which is characterized in your statement as a proposal is not yet a proposal. That is what amount the Administration would require to fill that budgetary gap. But the Labor Department has not yet articulated a specific proposal—point one.

Senator ROCKEFELLER. But you're talking about an increase of between 50 and 60 percent. It is nothing less than that.

Mr. WOOD. If we were to fill that entire budget gap outlined in the budget itself, yes, it would be 60 percent.

Senator ROCKEFELLER. Well, my advice would be to let the solution which was arrived at last year lie and give it a chance to work, because I don't see any evidence that it is not going to work. And in this era of a weak and vulnerable coal industry, I don't understand why you would pick on the coal industry. I don't think we need to do it to solve the Black Lung Trust Fund problem.

Mr. WOOD. Could I defer for a minute to Mr. DeMarce?

Senator ROCKEFELLER. Yes, and I would also like to inquire how much time is left for the vote.

Could you answer, please, sir, then I will leave and come back.

Mr. DEMARCE. Senator, as the law is now written, the tax falls back to a much lower rate, to 50 cents a ton for underground coal and 25 cents for surface-mined coal at the end of 1995. And the projections we have been able to make indicate that once that fallback in the rate occurs, there is no realistic prospect of solvency.

Senator ROCKEFELLER. Yes, but your assumption that the temporary tax will dissolve is the basis of the increase of the 60 percent. What if it were to be understood that it was not a temporary tax but a more permanent tax? Would that change your thinking?

Mr. WOOD. Well, if the 10-percent tax were made permanent, that would seem to be significant.

Senator ROCKEFELLER. Would it be enough so that you would withdraw the 60 percent additional increase?

Mr. WOOD. I can't speak definitively at this point, but I don't think that making the 10 percent permanent in and of itself would be sufficient to make the trust fund solvent in a reasonable period of time. The problem is that, after a certain number of years, one is just running numbers. And with the vicissitudes of the oil market, interest rates, a point can be off by a substantial degree.

The 1981 amendments, for example, that you mentioned, that doubled the excise tax on coal, were intended to make the trust fund solvent by Fiscal 1995, and it became obvious a few years following 1981 that that was not going to be the case, that oil prices had fallen significantly making coal less competitive, coal production itself was lower than anticipated by the Energy Department, and interest rates on the debt remained higher. For that reason, the trust fund was not going to be solvent by Fiscal 1995, and the Administration came back in the beginning of Fiscal 1985, I believe, for a further increase in the coal tax.

So, not only must the trust fund be made solvent, from the Administration's standpoint, but it must be made solvent within a reasonable timeframe.

Senator ROCKEFELLER. You recognize also—and then I must go, and we will recess this hearing for a moment—you understand that now, as opposed to the 40 percent of applications for black lung benefits accepted in the 1970's, it is down to a little bit over three percent. You understand that there are perhaps 40 percent fewer coalminers at this point in this country than there were just five to six years ago. So, I don't know whether you are taking the so-called "demographic situation" into consideration. I think your problem is going to resolve itself by 2014 through the agreement that we made last year, and I don't see the reason for tinkering with that agreement and doing damage.

Let me go and vote, and then we will return to this discussion.

(Whereupon, at 11:47 a.m., the hearing was recessed.)

AFTER RECESS

The CHAIRMAN. Let us come to order.

Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Secretary, as I indicated earlier, the 1982 average income for black lung beneficiaries was around $10,000, so one can assume it is slightly more than that now, but not much. Most black lung benefit recipients depend on half their income from the Black Lung benefit itself. It is a very fragile and vulnerable population.

The Senator from Rhode Island made some interesting comments earlier as to the program's extravagance in the earlier years, but I would point out that for those who have been in the coalmines it is not easy work. It is dangerous work. It is the single most difficult and dangerous work that takes place in this country, as far as I am aware. And when people have spent 10, 12, 14 years in the mine underground, there are very few who do not know it, from their chests, from their bodies.

Now, I am not going to argue the merits of black lung today—I support the program very strongly. Congress reined in on and tightened the eligibility criteria to an extraordinary extent in 1981.

My question is: Why did the Administration pick on the black lung victims to raise $180 million in new revenue? I don't understand that—you haven't touched veterans, or those who win awards from lawsuits, or those who receive other forms of disability compensation. The Administration's Treasury I and Treasury II proposed treated all these groups the same. Now, all of a sudden, black lung victims are being picked out, and the Treasury wants to make $180 million just from them alone. I don't understand that.

I don't want to see anyone have their disability benefits taxed. Disability benefits are not just replacement income for lost wages, but they are also compensation for high medical costs and related expenses. I don't think those two things can be divided.

Why is the Administration taking on black lung victims? Please explain that.

Mr. **Mentz**. Senator, I fully understand your concern. I was in your state on Monday of this week, and I heard much the same point of view expressed, "Why black lung?"

Incidentally, the revenue number that the Treasury has estimated is $21 million. That is the revenue that would come out of the part of the proposal dealing with taxation of the replacement of income piece of black lung.

Now, the tax policy philosophy was articulated, as you point out, in Treasury I, of taxing all forms of replacement of income as the equivalent of income, and therefore gross income subject to income tax.

I think the fact that there is only a $21 million revenue associated with this program is evidence, as I said in my remarks, that most of the recipients of these benefits are probably low-income people who, because of the changes imposed by tax reform, will probably not be paying much of any tax. But the $21 million here is very, very modest considering the overall size of the program—that request, the low-income people we are talking about, who are not going to be realizing income high enough to push them into a taxpaying condition.

Nevertheless, obviously some people will be in that situation. And the Treasury view would be that that is appropriate, just as it is appropriate for unemployment compensation and is appropriate for other forms of wage-replacement. You have mentioned a couple in your statement.

As to why black lung is singled out, I can't give you a good Treasury Department answer for that. I can see doing it across the board to all income-replacement substitutes, if you will, but black lung as opposed to others? I can't find the tax policy reason for that. Maybe there is another explanation, but I can't help you.

Senator **Rockefeller**. All right.

I would just conclude, Mr. Chairman, by saying I hope the reason that Treasury has singled out black lung victims, is not because coal is mined in relatively fewer states, and that there are relatively fewer Senators and relatively fewer Congressmen who can fight this, and therefore you have a relatively better chance to have it pass through the Congress. I hope that is not the case, because I think you will find that those of us from those states will be effective in to blocking this.

My final comment would be: I don't understand your figure of $21 million. Our understanding was that you were talking about at least $140 million from black lung victims. You cite $21 million, but $140 million is what I'm hearing is the projection. I don't understand that discrepancy, which is very, very large.

Mr. **Mentz**. That is the Treasury Department's estimate of what that proposal will raise in income tax revenue. We need to get together with your staff and figure out the discrepancy, but we are pretty confident of the $21 million number.

Senator **Rockefeller**. I have no further questions, Mr. Chairman.

The **Chairman**. Thank you very much, Senator Rockefeller.

Mr. Secretary, we are very pleased to have you before us, and thank you for your forthright testimony.

Mr. **Mentz**. Thank you, Mr. Chairman.

The **Chairman**. Dr. Utgoff, I apologize for the delays, and we would be pleased to hear you now.

[Mr. Mentz's written prepared testimony follows:]

Release Upon Delivery
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February 4, 1987

STATEMENT OF
J. ROGER MENTZ
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

It is my pleasure to be here today to discuss certain revenue initiatives included in the President's fiscal year 1988 budget proposal. I will address in particular the $6.1 billion of additional "governmental receipts" shown in the President's budget proposal.

It is extremely important that we not undo any of the dramatic and important tax reforms that were accomplished last year. Any increase in income tax rates or any new tax on the general population should be viewed as a breach of the pact reached last year to return, in the form of dramatically lower tax rates, any increase in revenue that would otherwise accrue from making the income tax base broader and fairer.

With this in mind, the President has proposed revenue initiatives in his budget for fiscal year 1988 that fall into three broad categories: first, collecting taxes owed but not paid; second, making certain trust fund reforms; and third, charging reasonable user fees for Federal programs that deliver services to identifiable beneficiaries. None of these initiatives constitutes a general tax increase for the American taxpayer. Rather, the proposals represent a strengthening of our present system and the elimination of certain unwarranted exceptions under current law.

I will discuss each of the revenue initiatives in turn, except for the proposal to increase Pension Benefit Guaranty Corporation premiums for employers. Another Administration representative will discuss this proposal.

Extend Medicare Hospital Insurance Coverage to all State and Local Government Employees

Background

State and local government employees who began work after March 31, 1986 are covered by Medicare Hospital Insurance, and a tax is imposed on both the employee and the employer to pay for this benefit. The rate of tax for 1987 is 2.9 percent of the employee's wages (up to $43,800), paid half by the employer and half by the employee. An employment tax for Medicare is not imposed, however, on the wages of State and local government employees who were hired before April 1, 1986.1/ Nonetheless, roughly 75 percent of such employees receive Medicare coverage because of eligibility through a spouse or because of a prior period of work in covered employment. Medicare coverage is mandatory for Federal employees, regardless of when hired.

Proposal

The Administration proposes to extend Medicare coverage to State and local government workers hired before April 1, 1986.

Discussion

Extension of Medicare coverage to State and local government employees hired before April 1, 1986, who are the only major group of employees in the United States not participating fully in Medicare, would ensure that the 25 percent of such employees who are not currently covered receive the benefits of Medicare. Such a change also would eliminate the charge to the Medicare trust fund caused by the fact that most State and local employees, even though they are not subject to the payroll tax, are nevertheless covered by Medicare.

Revenue Impact

We estimate that this change in Medicare coverage, proposed to be effective January 1, 1988, will increase receipts by $1.6 billion in the 1988 fiscal year.

1/States and localities are authorized to extend Medicare coverage to employees hired before April 1, 1986, if they enter into a voluntary agreement with the Department of Health and Human Services.

Expand Employer's Share of Social Security Taxes to Include All Cash Tips

Background

Under Chapter 21 of the Internal Revenue Code of 1986 ("Code"), relating to Federal Insurance Contribution Act ("FICA") taxes used to fund the Social Security system, a tax is imposed on the employee and the employer, based on the wages paid to the employee. In general, the tax imposed on the employee and the employer is equal. The employer is responsible for withholding the employee's share of the tax from the employee's wages and remitting the tax, together with the employer's share of the tax, to the Internal Revenue Service. The current tax rate for both the employer and the employee is 7.15 percent of wages, consisting of 5.7 percent for Old-Age, Survivors and Disability Insurance and 1.45 percent for Medicare Hospital Insurance.

Section 3121(q) of the Code provides that for purposes of chapter 21 of the Code, other than the tax imposed on employers, tips received by employees are considered remuneration for services and are subject to the FICA tax imposed on employees. The tips are generally deemed to be received at the time the employee files a written statement with the employer reporting the receipt of the tips, as is required under section 6053 of the Code.

The full amount of tips received by an employee is not, however, usually subject to the FICA tax imposed on the employer. Under section 3121(t) of the Code, if an employer pays an employee wages that are below the Federal minimum wage, and the employee also receives tips in the course of his or her employment, the employee is deemed to receive wages equal to the Federal minimum wage for purposes of the employer's share of FICA taxes. Any tips received in excess of the difference between the wages paid and the minimum wage, however, are not subject to the employer's portion of the tax.

To illustrate the effect of this rule, assume that an employee earns $6.25 an hour as a waiter, consisting of $2.25 an hour in wages and $4.00 an hour in tips. The employee is required to pay social security tax on the full $6.25 an hour, subject to the applicable wage base limitation. The employer is only required to pay the tax on the Federal minimum wage, currently $3.35 an hour, rather than the full $6.25 an hour.

Proposal

The Administration proposes that all cash tips be included within the definition of wages for purposes of the employer's share of FICA taxes. Thus, employers would be required to pay FICA taxes on the total amount of cash tips (but, obviously, not in excess of the Social Security wage base).

Discussion

Requiring the employer to pay FICA taxes on the same amount of wages as does the employee--salary plus tips--follows the general structure of Chapter 21 that requires an equal tax to be paid by both parties. This proposal would thus eliminate the advantage currently enjoyed by some employers (those whose employees receive a portion of their wages by means of tips) and not by other employers.

In addition, employees under present law earn Social Security credit for the full amount of tips received, while the employer's share of FICA taxes is usually based on a smaller amount. In effect, the Social Security trust fund is subsidizing the employer to the extent of the employer's share of FICA taxes on any tips received by an employee in excess of the difference between the employee's wages and the Federal minimum wage. The fact that the employer does not directly pay the tips to the employee should not excuse the employer from payment of its share of FICA taxes. In substance, tips received by employees are the economic equivalent of wages and should be taxed in the same manner.

Present law regarding tips also creates an administrative burden for the Social Security Administration ("SSA") because separate records must be kept of the amount of reported tips for tax accountability purposes. Each year the U.S. Treasury transfers to the Social Security trust fund the amount of FICA taxes due on the total wages reported to the SSA during the prior year. Because no FICA taxes are paid by the employer on tips (other than the amount necessary to bring the employee's salary up to the minimum wage), the SSA must keep a separate record of tips so that it will be able to tell the Treasury Department the total amount of wages on which both employer and employee taxes are due and the total amount on which only employee taxes are due.

Revenue Impact

We estimate that the inclusion of the full amount of cash tips in the definition of wages for all purposes, proposed to be effective January 1, 1988, will increase receipts in the 1988 fiscal year by $0.2 billion.

Extend Social Security Coverage to the Inactive Duty Earnings of Armed Force Reservists and to Earnings of Certain Students, Agricultural Workers, Individuals Aged 18-21 who Work for their Parents, and Individuals who Work for their Spouses

Background

Social Security taxes are imposed on the "wages" of an employee received as remuneration for "employment," both terms being defined in section 3121 of the Code. An employee only receives Social Security credit for his earnings if his salary constitutes wages under section 3121 and if his job is included in the definition of employment ("covered employment").

Armed Forces Reservists. Approximately 1.4 million Armed Forces reservists do not receive Social Security credit and are not subject to Social Security taxes for their inactive duty earnings, because "inactive duty training" (generally, weekend training drill sessions) has not been included as covered employment under section 3121. Earnings from full time active duty or from "active duty for training" (training sessions lasting several weeks) constitute covered employment under current law.

Students. Services performed by a student under various circumstances in an academic setting are excluded from coverage under Social Security and the student's wages are not subject to FICA taxes. Such students include those employed by a school they are attending (or college club or an auxiliary nonprofit organization of a school) and student nurses employed by a hospital or nurses' training school they are attending.

Agricultural Workers. Under present law, cash remuneration paid to an employee in any taxable year for agricultural labor is excluded from the definition of wages unless the employee receives more than $150 during the year for such labor or the employee works for the employer more than 20 days during the year.

Individuals Aged 18-21. Services performed by individuals under age 21 who are employed by their parents, even if employed in the parent's trade or business, do not currently constitute covered employment.

Spouses. Services performed by an individual in the employ of his spouse do not constitute covered employment.

Proposal

The Administration proposes to include services performed by reservists in "inactive duty training," by students employed by their educational institution, by individuals aged 18-21 working for their parents in a trade or business and by individuals working for their spouses in a trade or business, in the definition of covered employment. The Administration also proposes, with respect to agricultural labor, that: (a) any remuneration for agricultural labor paid by an employer to an employee constitute wages if the employer pays more than $2,500 to all employees for such labor during the taxable year, (b) the $150 annual cash pay test continue to be applied if the $2,500 annual payroll test is not met, and (c) the 20-day test be eliminated.

Discussion

Armed Forces Reservists. The proposal to include inactive duty training, commonly called monthly drill training, within the definition of covered employment would improve Social Security protection for reservists. Such training was not originally included in the definition of covered employment for two reasons: (1) because most reservists were covered under Social Security through their regular work, coverage of monthly drill training, which involved very small amounts of pay, would have resulted in little additional Social Security protection for reservists; and (2) reporting pay for monthly drill training would have imposed an undue administrative burden on reserve units.

These reasons for not covering inactive duty training are no longer compelling. The pay for a monthly drill training is now substantial. Such drill pay accounts for approximately 70 percent of a reservist's annual reserve earnings. Generally, a reservist is required to train at least one weekend monthly. Drill pay ranges from approximately $1,000 to $3,800 a year for enlisted members and from $1,700 to $9,000 for officers.

The proposal would not create an administrative burden for reserve units, because they now withhold Federal income taxes from wages paid to reservists for all services, including inactive duty training. Indeed, because reservists' pay would be treated the same for Social Security and Federal income tax purposes, the proposal would reduce reporting complexities.

Students. The reason for excluding certain student services from the definition of covered employment was that the small amount of protection students would gain would not be proportionate to the wage reporting and tax payment burden imposed on their employers. However, because in most instances the employer is now required to withhold income taxes from such earnings and because payroll practices have become more sophisticated, the administrative burden placed on employers by the proposal is not unreasonable.

Furthermore, students employed by their educational institutions need the protection of the Social Security program as much as other workers. Because of this exclusion, students may not gain any Social Security protection or may have gaps in their protection. This is important because features have been added to Social Security that are particularly desirable for younger workers (e.g., disability benefits and Medicare for the disabled). Finally, changes in the student population itself have increased the students' need for protection--students today are older, stay in school longer and are more likely to be married and have children.

Agricultural Workers. The proposal to adopt an annual $2,500 threshold test for agricultural employers would result in the coverage of more than 95 percent of the remuneration paid to all farm workers and would improve the Social Security protection afforded to about three-quarters of a million farm workers and their dependents. The proposal will not unreasonably increase the recordkeeping burden of farm employers. In particular, farms with expenditures in excess of $2,500 for farm wages will in all likelihood already report wages for Social Security purposes for at least some employees who meet the coverage test under current law. These employees will thus already be familiar with Social Security tax recordkeeping. The 20-day test would be eliminated under the proposal because, due to increased wage levels for farm work, employees will normally meet the $150 test well before working for 20 days.

Individuals Aged 18-21. Individuals between the ages of 18 and 21 who are employed by their parents cannot acquire the Social Security coverage which is available to other employees the same age who perform the same or similar services for employers other than their parents. Changing the law to provide coverage for an individual aged 18 or older employed in his parent's business also would eliminate a potential tax avoidance device whereby self-employed persons may be able to use the present coverage exclusion to reduce their own Social Security taxes. Under present law, the self-employed person can take the position that paying a child under age 21 a large salary, which is not subject to the Social Security tax, and claiming the salary as a business deduction, will thereby reduce the amount of the parent's income that is subject to the Social Security self-employment tax.

Spouses. Under current law, an employee spouse is not covered under Social Security in the same manner as other employees. The employee spouse, even one who has some prior earnings from covered employment, may not have disability protection and will have reduced retirement protection. More significantly, in cases where the employee spouse had no prior earnings from covered work, he will have no Social Security protection in his own right. Accordingly, if the spouses were to divorce within ten years of marriage, the employee spouse would lose eligibility for Social Security auxiliary or survivor benefits and would have no protection despite years of employment. The Administration's proposal would provide a married person who is actually performing services and being paid wages as an employee of his spouse with protection under the Social Security system.

The exclusion for an employed spouse also lends itself to a tax avoidance device, similar to that described above for children, under which a married couple working together in a business may attempt to reduce their Social Security tax liability by paying a large salary to the employed spouse, thereby lowering the amount of self-employment income taxable and creditable to the other spouse. The proposal to repeal the exclusion for such wages removes this potential artificially to lower FICA tax payments when a couple operates a business together.

Revenue Impact

The changes in Social Security coverage described above, proposed to be effective January 1, 1988, are estimated to increase receipts by $0.2 billion in FY 1988.

Treat Employer-Provided Group-Term Life Insurance as Wages for Purposes of Social Security Taxes

Background

The value of group-term life insurance coverage provided to an employee is excluded from the definition of "wages" in section 3121 of the Code. For income tax purposes, however, the value of such insurance, other than the cost of the first $50,000 of coverage provided to an employee, is included in taxable income. Moreover, if the insurance coverage is provided to employees in a manner that discriminates in favor of key employees, then the entire cost of the coverage is included in taxable income of the key employees.

Proposal

The Administration proposes to conform the treatment of group-term life insurance for Social Security tax purposes to its treatment under the income tax. Accordingly, the cost of group-term life insurance would be included in the definition of wages for purposes of FICA taxes if the cost were taxable to the employee.

Discussion

The proposal would treat the provision of group-term life insurance the same for both FICA and income tax purposes. There is no Social Security program rationale for the unlimited exclusion of this employee fringe benefit. The FICA tax status of certain other fringe benefits, such as group legal services, meals and lodging, educational assistance, and dependent care assistance, has similarly been tied to the income tax status of such benefits.

Revenue Impact

We estimate that the inclusion of certain group-term life insurance in the definition of wages, proposed to be effective January 1, 1988, will increase revenue by $43 million in fiscal year 1988.

Repeal Certain Exemptions from Gasoline and Other Highway Excise Taxes

Background

The Highway Trust Fund, which is used to finance Federal assistance for highways and for mass transit systems, is funded by highway user fees, including excise taxes on gasoline, diesel fuel and tires, a sales tax on heavy trucks and trailers, and a heavy truck highway use tax.

Although the Highway Trust Fund is intended to be funded by all who use the nation's highways, there are several exceptions to this general rule. In particular, gasohol and certain other alcohol fuels, as described below, are partially exempt from the excise taxes on gasoline and diesel fuel. State and local governments are fully exempt from all Federal highway excise taxes. Public bus operators are fully exempted from Federal gasoline, diesel fuel, and other highway excise taxes. Private bus operators are fully exempt from the excise tax on tires and are partially or fully exempt from certain other excise taxes.

Proposal

The Administration proposes to repeal the exemptions from the highway excise taxes described above.

Discussion

Alcohol Fuels. Under current law, the general tax rate is 15 cents per gallon for diesel fuel and 9 cents per gallon for gasoline and special motor fuels. An exemption of 6 cents per gallon is provided for gasohol and certain alcohol fuels (neat methanol and ethanol fuels that contains 85 percent or more alcohol) produced from a substance other than petroleum or natural gas, and an exemption of 4 1/2 cents per gallon is available for such alcohol fuels produced from natural gas. The exemption of gasohol and alcohol fuels from the excise taxes for highway use distorts the allocation of resources. It also encourages users to purchase fuels that have a higher economic cost than the alternative fuels because the tax system lowers the cost of the subsidized fuel. Moreover, the exemptions allow users of the highways to escape paying their fair share of the applicable use taxes. Accordingly, the Administration proposes to repeal these excise tax exemptions. (The Administration does not propose that the alcohol fuel tax credit, described in section 40 of the Code, be repealed).

Bus Operators, State and Local Governments. Highway Trust Fund taxes are designed to charge users of the public highways for the wear and tear they cause and for the Federally funded highway improvements made for their benefit. The exemptions for bus operators and for State and local governments are inconsistent with having all highway users paying their fair share of the cost of maintaining and improving our highway system.

Revenue Impact

We estimate that the repeal of these special exemptions, proposed to be effective October 1, 1987, will increase receipts by $0.6 billion in FY 1988.

Increase Excise Tax on Coal Production; Treat Black Lung Income Replacement Benefits as Taxable Income

Background

The Black Lung Disability Trust Fund, which provides benefits to individuals (and their survivors) disabled by pneumoneucleosis (black lung disease), is funded in part by an excise tax on the sale of coal by producers. The current rate of tax is $1.10 per ton for coal from underground mines and $.55 per ton for coal from surface mines, with a cap of 4.4 percent of the sales price for each ton of coal produced. The Trust Fund is presently $2.9 billion in debt, even though the Federal government has assumed responsibility through the General Fund for paying $1 billion a year in income replacement benefits for some miners, whose benefits are distributed by the Social Security Administration from general revenues, and the General Fund is currently bearing the interest costs on the amounts the Trust Fund has borrowed.

Under section 104(a)(1) of the Code, black lung replacement income benefits are excluded from taxable income.

Proposal

The Administration proposes to increase the excise tax on the sale of coal by producers to $1.70 per ton for coal from underground mines and $.85 per ton for coal from surface mines, subject to a cap of 6.8 percent of the sales price. This rate would apply through 1990, with decreasing rates thereafter. The Administration also proposes to repeal the requirement that the General Fund bear the interest costs incurred by the Trust Fund, and proposes that black lung replacement income benefits be included in taxable income.

Discussion

The excise tax proposed by the Administration is necessary to reduce and eventually to eliminate the deficit in the Trust Fund. The Administration's 1988 budget proposes certain changes to slow the growth of black lung benefit payments, including a one-year freeze on cost-of-living adjustments for benefits. Because benefit changes alone will not permit retirement of the Trust Fund's indebtedness, however, the excise tax on coal must be increased to restore the Trust Fund to solvency.

The exclusion of black lung income replacement benefits from taxable income is inappropriate because it allows income that is merely replacing taxable income to escape tax.

Revenue Impact

The increased tax on coal production and sale, proposed to be effective October 1, 1987, will increase FY 1988 receipts by $0.3 billion. The inclusion of the black lung replacement income benefits in income, proposed to be effective January 1, 1988, will increase FY 1988 receipts by $21 million.

Increase Contributions to the Rail Industry Pension Fund; Extend Federal Unemployment Tax to Railroad Employment

Background

The rail industry pension fund is financed primarily by payroll taxes imposed on covered employers and their employees. Under present law, both the employer and the employee pay a "Tier I" tax that is equivalent to the Social Security taxes. In addition, a Tier II tax is paid by both the employer and the employee. The current rate of the Tier II tax is 14.75 percent for employers and 4.25 percent for employees, computed on the first $32,700 of the employee's salary.

Railroad employment is not presently covered by the Federal-State unemployment insurance system. Railroad employees are covered by a separate Railroad Sickness and Unemployment Fund, which is financed by payroll taxes levied on rail employers. The Fund has been insolvent for 22 of the last 27 years. It currently owes approximately $800 million to the rail pension fund.

Proposal

The Administration proposes to increase railroad retirement Tier II taxes by a total of 1.5 percentage points effective January 1, 1988, and by an additional 1.5 percentage points effective January 1, 1989. This increase will be shared by the employer and the employee. Railroad workers would become covered under the Federal-State unemployment insurance system beginning with transitional coverage on October 1, 1987. Railroads would begin paying taxes under the Federal Unemployment Tax Act effective January 1, 1988.

Discussion

Financing legislation for the rail industry pension fund enacted in 1974, 1981, and 1983 was based on certain assumptions as to the level of railroad employment and the level of pension contributions necessary to keep the Fund solvent. Those assumptions have proven to be incorrect and an increase in rail pension contributions, as recommended by rail pension actuaries, is needed in order to ensure the solvency of the Fund. Bringing rail employees within the Federal-State unemployment insurance system would result in these employees receiving the same unemployment insurance benefits as do other employees. This proposal would repay the $800 million debt to the rail pension fund.

Revenue Impact

We estimate that the additional pension fund contributions, proposed to be effective January 1, 1988, and again on January 1, 1989, will increase receipts by $0.1 billion in 1988 and $0.3 billion in 1989. We estimate that coverage of rail employees under the Federal-State unemployment insurance system, beginning with transitional coverage on October 1, 1987, will increase receipts by $0.1 billion in 1988.

Repeal the Windfall Profit Tax

Background

Under current law, an excise tax is imposed on domestically produced crude oil. Taxable crude oil is classified in three tiers. Generally, oil in tier one is "old" oil that had been subject to price controls; oil in tier two consists of oil produced by a stripper well, plus petroleum reserve oil; and oil in tier three is newly discovered oil, tertiary oil and heavy oil. The base for the tax is the difference between a statutory base price (lower for tier one oil and progressively higher for tiers two and three), adjusted for inflation, and the amount for which oil is sold, less a severance tax adjustment. The tax rate is 70 percent for tier one oil, 60 percent for tier two oil, and 30 percent for tertiary oil and heavy oil. The tax rate for newly discovered oil is 22-1/2 percent through 1987, 20 percent for 1988 and 15 percent for 1989 and thereafter. Independent oil producers are taxed at a 50 percent rate for tier one oil with respect to 1,000 barrels per day of production and are exempt from the windfall profit tax on stripper well oil.

The windfall profit tax is scheduled to phase out over a 33-month period beginning in January 1991, or the first month after December 1987 in which cumulative net receipts exceed $227.3 billion, whichever date occurs first.

Proposal

The Administration proposes to repeal the windfall profit tax.

Discussion

The windfall profit tax was enacted in 1980 when a dramatic increase in the price of domestic crude oil was expected due to the decontrol of that price. Although the price of domestic oil did initially reach record highs, in recent months the price of oil has dropped so much that it is now below its pre-decontrol level (when adjusted for inflation). Consequently, little or no windfall profit tax is being collected, and the tax itself is, therefore, no longer appropriate. Even if crude oil prices again rise to levels that would generate significant profits for domestic oil producers, such profits would, in no way, be considered "windfall" profits. This is because a return to a profitable situation for domestic oil producers would be the result solely of market conditions (here and abroad) and not the result of the government lifting an artificial price barrier, as was the case when the tax was first imposed.

In general, the Tax Reform Act of 1986 was designed to produce uniform rates of taxation on the income generated in different activities, and to eliminate tax-induced distortions in investment. Repeal of the windfall profit tax is consistent with that objective.

Revenue Impact

Under the Administration's current oil price projections, the repeal of the Windfall Profit Tax would not have any revenue impact in 1988, or at any time prior to 1991.

Revise Customs Users Fee

Background

In 1986, Congress enacted an ad valorem users fee on imports. The rate of the fee is 0.22 percent of value in 1987, dropping to 0.17 percent in 1988. For 1989, the Secretary of the Treasury is authorized to reduce the fee so that the amount realized is equal to the amount necessary for salaries and expenses for the commercial operations of the Customs Service. The fee is scheduled to expire on September 30, 1989. The reason for enacting this fee was to ensure that the costs of services provided by the U.S. Customs Service are borne by the users of those services and not by the general taxpayer. Accordingly, the proceeds of the fee are deposited into a dedicated Customs Service account and are used exclusively for the funding of Customs costs in processing all commercial imports.

Particular goods, including those imported under Schedule 8 of the Tariff Schedules (which includes products containing U.S. components--item 807.000 in the Schedules), are exempt from the fee.

Proposal

The Administration proposes to provide the Secretary of the Treasury the authority to prescribe and collect fees, on a transaction cost rather than ad valorem basis, for the provision of any Customs service performed in connection with the processing of any merchandise that is entered into the United States or admitted to a foreign trade zone, or withdrawn from a warehouse, foreign trade zone, or other bonded status. These fees would apply indefinitely. In addition, the Administration proposes that the revised user fee will apply to all imports as determined by the Secretary of the Treasury, after consultation with the heads of other departments.

Discussion

The application and extension of the user fee to all imports entering the country is consistent with the concept that those who benefit from specialized government services should pay for them directly. Last year, Congress took the first important step by imposing an ad valorem fee, and the Administration now proposes the enactment of authority to permit the full recovery of Customs costs incurred while processing cargo.

Revenue Impact

The elimination of the exception for the goods listed in Scheduled 8, proposed to be effective on July 1, 1987, is estimated to increase receipts by $0.1 billion in the 1988 fiscal year.

Extend the Airport and Airway Trust Fund Excise Taxes

Background

The Airport and Airway Trust Fund provides money for airport construction, facilities and equipment for the air traffic control system, research and development, and Federal Aviation Administration operating expenses. The Trust Fund is financed by a variety of user fees, including excise taxes on airline fares, aviation fuel, and air shipments. These user fees are scheduled to expire on December 31, 1987.

Proposal

The Administration proposes to extend existing airport and airway user fees for an additional two-year period.

Discussion

Consistent with its position that the users of Federal services should help pay for such services, the Administration believes that the Airport and Airway Trust Fund should continue to be funded by means of user fees such as the excise taxes described above.

Revenue Impact

The revenues from the extension of the user fees described above is not reflected in the $6.1 billion of new revenues shown in the Administration's budget proposal because it is an extension of an existing tax.

Impose User Fees for the Bureau of Alcohol, Tobacco, and Firearms

Background

A variety of excise taxes are currently imposed on alcohol and tobacco products and firearms. Present law does not specifically impose fees on alcohol, tobacco or firearm businesses, however, to compensate for the costs incurred in monitoring compliance with Federal law.

Proposal

The Administration proposes that user fees, primarily in the form of licensing and permit fees, be paid by individuals and firms who make use of the services provided by the Bureau of Alcohol, Tobacco and Firearms ("BATF").

Discussion

As with other user fees proposed in the Administration's 1988 budget, the user fees proposed for the BATF would require those persons making use of the specialized services of the government, in this case those provided by the BATF, to help pay for such services. Such fees would include, for example, licensing and permit fees for certain manufacturers, dealers and importers of firearms, ammunition and explosives; and similar fees for certain producers, processors and retailers of alcohol and tobacco. In addition to licensing and permit fees, the BATF would charge special fees to help recoup the costs associated with certain unique services provided to the alcoholic beverage and tobacco industries such as fees for laboratory analysis and certification.

Revenue Impact

We estimate that the proposed BATF user fees will increase 1988 receipts by $50 million.

Increase Internal Revenue Service Funding

Background

As a result of the Tax Reform Act of 1986, it is easier for taxpayers to pay the correct amount of taxes and for the Internal Revenue Service ("IRS") to determine how much each taxpayer owes. Nevertheless, a large gap still exists between the amount of taxes owed and the amount paid.

Proposal

The Administration proposes to increase IRS funding for the 1988 fiscal year.

Discussion

Increased IRS funding for the 1988 fiscal year will ensure the smooth implementation of tax reform, will improve enforcement of the tax laws, and will help close the gap between taxes owed and taxes paid.

Revenue Impact

We estimate that the proposed increases in IRS funding will increase receipts in the 1988 fiscal year by $2.4 billion.

* * *

This concludes my prepared remarks. I would be pleased to respond to any questions.

STATEMENT OF DR. KATHLEEN P. UTGOFF, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Dr. UTGOFF. Thank you, Mr. Chairman.

I became Executive Director of the Pension Benefit Guaranty Corporation 18 months ago. Since that time its deficit has increased over eightfold, to an estimated $4 billion. I am one in a long line of my predecessors who have been saying that the financial problems of the Pension Guaranty Pension Corporation would have to be dealt with soon. And given what has happened in the last year, I think it is clear that that "soon" has now become "today."

The PBGC, as you know, was created by Congress to protect the retirement income of what is now 38 million American workers, but the current state of our program really inspires very little confidence.

Our $4 billion deficit represents $4 billion worth of pension promises for which the PBGC has assumed responsibility, but it has no cash to pay when those promises fall due. Unfortunately, more large terminations and even higher deficits are likely. Even if no new plans terminate, we expect to pay about $300 million more in benefit payments than we have taken in in premiums in Fiscal Year 1988. By liquidating our assets, we can continue to operate and meet our commitments for several years, but the day is approaching when the PBGC will not have enough cash to pay promised benefits.

Last year the Congress approved a PBGC premium increase and a number of reforms in the way that the pension insurance program operates. But that premium increase was not enough to support the very large terminations that have taken place recently, and the program reforms, although welcome, were not enough to protect the program from large terminations and escalating deficits in the future.

Because the steps taken in 1986 did not solve our problem, the PBGC is forced to come back to Congress to ask for more money and additional remedial legislation. In broad outline, three measures are needed:

First, more revenue. The commitments that have already been made to retired and active workers must be met, and there is no way to do this without a substantial increase in premiums.

Second, a fair and more efficient premium structure. The PBGC's flat rate premium was acceptable when the program's charges were negligible, but with increasing premiums, a more equitable method of spreading costs is essential.

Third, changes in the rules governing the funding of pension plans, so that employers cannot minimize their contributions and then escape responsibility for fulfilling their pension promises.

The Administration is also developing another legislative proposal that would make significant changes in the minimum funding standards. This proposal will be transmitted to Congress in the near future.

My testimony today will deal chiefly with the first and second of these items. I think it is important to keep in mind, and Senator Heinz pointed it out, that no one measure in isolation will solve the

PBGC's problems. Only a combination of higher premium revenues, an improved premium structure, and substantial program reform can meet the crisis that threatens the pension insurance system.

These remedies are not simple and painless. To understand why they are needed, and why half-measures will simply lead to more pain in the future, we need to look more closely at what the PBGC does and why the program has become so expensive.

Congress established the PBGC's single-employer pension insurance program in 1974 as a "safety net" for workers who depend upon private pension plans for a substantial share of their retirement income. Very few expected the program to be big or costly. A study by the Departments of Labor and Treasury, based on actual plan terminations in 1972, concluded that claims against the insurance program would be in the neighborhood of $30–$40 million a year, for which an almost nominal premium of a dollar per plan-participant per year would suffice. It soon became evident that these expectations were way too optimistic.

In 1977, the Corporation found it necessary to ask that the dollar premium be more than doubled. Congress raised it to $2.60 per participant effective January 1, 1978. By 1982, the $2.60 had proved inadequate, and the PBGC requested another increase. After a four-year delay, this request was acted upon, and the premium was fixed at $8.50 per participant effective January 1, 1986. Unfortunately, by the time the legislation was passed it was already clear that the $8.50 was not enough. Now our premium revenue must be more than doubled if we are going to return this program to solvency.

The reason for this gloomy progression of underestimates is not bad forecasting or bad luck. Rather, the advent of PBGC has changed incentives, and some companies have responded by taking advantage of opportunities to profit at their competitors' expense. The PBGC's valuable and necessary insurance function is now being overwhelmed by its role as a dispenser of subsidies and redistributor of corporate wealth. These large subsidies are not awarded according to any rational criteria; instead, they go to a few firms that have purposely underfunded their pension promises.

Under present law, a company with an underfunded pension plan can continue making pension promises to its employees, even if there is no intention or hope of ever paying for those promises. If pension insurance did not exist, these underfunded pension promises by troubled companies would not be worth very much to workers. But the PBGC's backing makes underfunded pensions almost as valuable as those that are fully funded. In effect, the present rules permit a few companies to pay their workers using somebody else's money.

So long as the PBGC insurance program has these characteristics, claims against it will remain uncontrollable. The corollary of uncontrollable claims is uncontrollable premiums. And uncontrollable premiums threaten the defined benefit pension system which has long been the backbone of private pensions.

Companies will not willingly continue to underwrite other companies' pension problems; at some point they will decide that their premium dollars can be better used elsewhere. They will replace their defined benefit pension plans with other arrangements. When well-funded plans leave the system, the premium burden on the remaining plans increases, making the other well-funded plans likely to "rush for the door."

Clearly, the present PBGC premium structure presents us with a dilemma: If premiums are not increased, the insurance program will run out of money in the not too distant future. But higher flat rate premiums are an unjustified tax on well-funded plans and may push employers away from defined benefit plans.

The Administration believes the best solution to this dilemma is a variable-rate premium that charges more to underfunded pension plans. Under a variable-rate premium, an amply funded plan that poses little risk to the PBGC would not pay the same premium as a plan of the same size with tens of thousands of dollars of underfunded pension promises per participant.

The concept of a variable-rate premium has been around for many years. The Congress considered it when ERISA was enacted, but decided at that time that the amounts involved were too small to justify anything more complex than a simple flat-rate per-capita premium. Since then, the Grace Commission recommended a variable-rate premium, and Congress has asked the PBGC to study the feasibility of a variable-rate premium.

We have also received a steady stream of comments from the private sector objecting to flat-rate premiums and urging their replacement by a more equitable system. In our view, the time has come to adopt a variable-rate premium. This reform is included in the President's Budget for Fiscal Year 1988, and we will be submitting a legislative proposal in the near future. Over the next few weeks, we will be seeking Congressional input as we finalize our proposal.

I should like to stress that our proposal will not be and is not intended to be the ultimate, absolutely perfect variable-rate premium. We have aimed for simplicity, omitting some of the features that might be desirable in principle but that would make the proposal harder to understand and to implement.

What we are considering is a two-part premium. The first part would be a flat rate per participant, close to the present $8.50. This charge would cover costs that cannot easily be allocated on the basis of the likelihood of future claims; for example, the PBGC's administrative expenses and a share of deficit that has accumulated in the past.

The second part of the premium would be based on the plan's funded status. This charge would be zero for plans that exceeded some basic level of secure funding. For plans that were less well-funded, there would be a charge based on the difference between this basic level and actual plan assets. We expect this charge would be about $6.00 to $10.00 per $1,000 per participant. So, if a plan were under-funded by $2,000, it would range from $12 to $20 per participant.

To make sure that the premium would not be an intolerable burden on any company, there would be a cap on the premium, regardless of the magnitude of under-funding.

We are also considering a formula for adjusting premiums automatically in future years to meet the insurance program's changing needs.

We estimate that, for two-thirds of the plans and almost 60 percent of the participants covered by the single-employer program, our proposal will result in no increase in premiums. For many other plans, the increase will be smaller than it would be if the PBGC raised its flat per-capita premium to produce the same aggregate revenue.

This version of a variable-rate premium also minimizes complexity. Premium calculations would be based on data that are already compiled by plans.

Also, contrary to fears expressed by some, the new premium would not impose an intolerable burden on troubled companies. The maximum premium would be less than many companies pay per worker for one month's health insurance coverage. Only a tiny percentage of companies would pay the maximum premium, and many of them will have plans that are under-funded by $20,000 or more per participant.

A variable-rate premium will be a major step toward restoring the health of the PBGC pension insurance program, without adverse side effects on soundly-funded defined benefit pension plans. Changing the premium structure will not, however, be a panacea for the PBGC's problems.

Long-term structural reforms are clearly needed if the PBGC is to avoid the kind of losses we have already absorbed. We believe, in particular, that ERISA's minimum-funding standards need to be reexamined in an effort to find ways to require better funding of plans whose funding has been grossly inadequate, without imposing extra costs on sponsors of well-funded plans.

Thank you for the opportunity to appear before you today on behalf of the PBGC.

The CHAIRMAN. Thank you, Dr. Utgoff.

The last thing I want is another band-aid on this program.

I would take you back to 1974, when I was in charge of the ERISA legislation in this committee. We had joint jurisdiction with the Labor Committee. They did it it in their committee and then we did it here. And I can well remember the negotiations, when I kept asking how much it was going to cost. They were telling me, "Not a dollar," like you cite here, "but 50 cents." That was going to be all that was needed. I said, "Are you sure that is all that is needed?" And they said, "Absolutely." I said, "Fine. Let's double it; let's make it a dollar. Let's go for broke. Let's just be sure we've got it." And in about three years, the PBGC came back in asking to double it again. Last year the PBGC was in here again asking for a substantial increase, and now you are in asking for another premium increase. Last year I guess it was a 300-percent increase.

What I fault you on, though, is not being able to see some of what was coming at you last year, in that kind of a situation. You had an LTV situation, and it was quite obvious they hadn't made a pension contribution since 1983, as I recall.

You point some other things out. Those companies that purposefully under-fund and tell their employees they are going to take care of them, with an idea that they were going to have an out with the Government stepping in, I think that is outrageous.

Dr. UTGOFF. Yes, Senator.

The CHAIRMAN. And we ought to address that. I do think you need fundamental changes and reforms in it, and I will be deeply interested in the proposals made in that regard.

I listen with interest to the idea of finally going to a variable fee. We did consider that at the time and did think it was too much of a technical detail problem to have to fool with, because we figured a dollar really wasn't that kind of a burden, mainly if we could have it uniform.

But I find the proposal very interesting, and I will look to your fleshing it out and letting us see just what it will do. I am deeply interested in this subject. I just don't want these people's savings turning to dust, and I don't want to see companies copping out and alleging that they are taking care of their employees and then not doing it, and looking on this as their——

Dr. UTGOFF. Yes.

The CHAIRMAN. So, Doctor, I won't at this time further pursue it, but I am really looking forward to the proposal and will be interested in it.

Dr. UTGOFF. Thank you, Mr. Chairman.

[The prepared written testimony of Dr. Utgoff follows:]

TESTIMONY OF
DR. KATHLEEN P. UTGOFF
EXECUTIVE DIRECTOR
PENSION BENEFIT GUARANTY CORPORATION
BEFORE THE
SENATE COMMITTEE ON FINANCE

February 4, 1987

Mr. Chairman and Members of the Committee:

Since I became Executive Director of the Pension Benefit Guaranty Corporation - just eighteen months ago - its deficit, which stood at $462 million at the end of Fiscal Year 1984 has increased over eightfold, to an estimated four billion dollars. For years my predecessors and I have been saying that the growing financial problems of the pension insurance program would have to be dealt with soon. Soon is now today.

The PBGC was created by Congress to protect the retirement income of the 38 million Americans who are now covered by the program. But the current state of our program inspires little confidence. Our four billion dollar deficit represents four billion dollars worth of pension promises for which the PBGC has assumed responsibility but that it has no cash to pay when those promises fall due. Unfortunately, more large terminations and even higher deficits are likely. Even if no new plans terminate, we expect to pay out $300 million more in benefit payments than we take in in premiums in Fiscal Year 1988. By liquidating our assets, we can continue to operate and meet our commitments for several years, but the day is approaching when the PBGC will not have enough cash to pay promised benefits.

Last year, Congress approved a PBGC premium increase and a number of reforms in the way that the pension insurance program operates. But that premium increase was not enough to support the very large terminations that have taken place recently. And the program reforms, although welcome, were not enough to protect the program from large terminations and escalating deficits in the future.

Because the steps taken in 1986 did not solve our problem, the PBGC is forced to come back to Congress again, to ask for more money and additional remedial legislation. In broad outline, three measures are needed:

> First, more revenue. The commitments that have already been made to retired and active workers must be met, and there is no way to do this without a substantial increase in premiums.
>
> Second, a fairer and more efficient premium structure. The PBGC's flat rate, per capita premium was acceptable when the program's charges were negligible, but, with increasing premiums, a more equitable method of spreading costs is essential.
>
> Third, changes in the rules governing the funding of pension plans, so that employers cannot minimize their contributions and then escape responsibility for fulfilling their pension promises.

The Administration is also developing another legislative proposal that would make significant changes in the minimum funding standards. This proposal will be transmitted to Congress in the near future. My testimony today will deal chiefly with the first and second of these items. It is important to keep in mind however that no one measure, in isolation, will solve the PBGC's problems. Only a combination of higher premium revenues, an improved premium structure and substantial program reforms can meet the crisis that threatens the pension insurance system.

These remedies are not simple and painless. To understand why they are needed - and why half-measures will simply lead to more pain in the future - we need to look more closely at what the PBGC does and why the program has become so expensive.

Congress established the PBGC's single-employer pension insurance program in 1974 as a "safety net" for workers who depend on private pension plans for a substantial share of their retirement income. Very few expected the program to be big or costly. A study by the Departments of Labor and the Treasury, based on actual plan terminations in 1972, concluded that claims against the insurance program would be in the neighborhood of thirty or forty million dollars a year, for which an almost nominal premium of a dollar per plan participant would suffice.

It soon became evident that these expectations were too optimistic. In 1977, the Corporation found it necessary to ask that the dollar premium be more than doubled. Congress raised it to $2.60 per participant, effective January 1, 1978. By 1982, $2.60 had proven inadequate and the PBGC requested another increase. After a four-year delay, this request was acted upon, and the premium was fixed at $8.50 per participant, effective January 1, 1986. Unfortunately by the time the legislation was passed it was already clear that $8.50 was not enough. Now our premium revenue must be more than doubled if we are going to return this program to solvency.

The reason for this gloomy progression of underestimates is not bad forecasting or bad luck. Rather, the advent of the PBGC has changed incentives, and some companies have responded by taking advantage of opportunities to profit at their competitors' expense. The PBGC's valuable and necessary insurance function is being overwhelmed by its role as a dispenser of subsidies and redistributor of corporate wealth. These large subsidies are not awarded according to any rational criteria; instead, they go to a few firms that have purposely underfunded their pension promises.

Under present law, a company with an underfunded pension plan continues on making pension promises to its employees, even if it has no intention or hope of ever paying for those promises. If pension insurance did not exist, unfunded pension commitments by a troubled firm would not be worth very much to workers. But the PBGC's backing makes underfunded pensions almost as valuable as those that are fully funded. In effect, the present rules permit a few companies to pay their workers using somebody else's money.

So long as the PBGC insurance program has these characteristics, claims against it will remain uncontrollable. The corollary of uncontrollable claims is uncontrollable premiums. And uncontrollable premiums threaten the defined benefit pension system, which has long been the backbone of private pensions. Companies will not willingly continue to underwrite other companies' pension promises. At some point, they will decide that their premium dollars can be better used elsewhere. They will replace their defined benefit plans with other arrangements. When well-funded plans leave the system, the premium burden on the remaining plans increases making other well-funded plans likely to "rush to the door."

Clearly, the present PBGC premium structure presents us with a dilemma. If premiums are not increased, the insurance program will run out of money in the not too distant future. But higher _per capita_ premiums are an unjustified tax on well-funded plans and may push employers away from defined benefit plans.

The Administration believes the best solution to this dilemma is a variable rate premium that charges more to underfunded pension plans. Under a variable rate premium, an amply funded plan that poses little risk to the PBGC would not pay the same premium as a plan of the same size with tens of thousands of dollars of unfunded pension promises per participant.

The concept of a variable rate premium has been around for many years. Congress considered it when ERISA was enacted but decided at that time that the amounts involved were too small to justify anything more complex than a _per capita_ premium. Since then, the Grace Commission recommended a variable rate premium and Congress has asked the PBGC to study the feasibility of a variable rate premium. We have also received a steady stream of comments from the private sector objecting to flat rate premiums and urging their replacement by a more equitable system. In our view, the time has come to adopt a variable rate premium. This reform is included in the President's Budget for Fiscal Year 1988, and we will be submitting a legislative proposal in the near future. Over the next few weeks we will be seeking Congressional input as we finalize our proposal.

I should like to stress that our proposal will not be, and is not intended to be, the ultimate, absolutely perfect variable rate premium. We have aimed for simplicity, omitting some features that might be desirable in principle but would make the proposal harder to understand and to implement.

What we are considering is a two-part premium. The first part would be a flat rate per participant, close to the present $8.50 premium. This charge would cover costs that cannot easily be allocated on the basis of the likelihood of future claims, for example, the PBGC's administrative expenses and a share of the deficit that was accumulated in the past.

The second part of the premium would be based on the plan's funded status. This charge would be zero for plans that exceeded some basic level of secure funding. For plans that were less well-funded, there would be a charge based on the difference between this basic level and actual plan assets. We expect that this charge would be about $6.00 to $10.00 per $1,000 per participant. To make sure that the premium would not be an intolerable burden for any company, there would be a cap on the premium, regardless of the magnitude of underfunding.

We are also considering a formula for adjusting premiums automatically in future years to meet the insurance program's changing needs.

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Also, contrary to the fears expressed by some, the new premium would not impose an intolerable burden on troubled companies. The maximum premium would be less than many companies pay per worker for one month's health insurance coverage. Only a tiny percentage of companies would pay the maximum premium and many of them will have plans that are underfunded by $20,000 or more per participant.

A variable rate premium will be a major step toward restoring the health of the PBGC pension insurance program without adverse side effects on soundly funded defined benefit plans. Changing the premium structure will not, however, be a panacea for the PBGC's problems.

Long-term structural reforms are clearly needed if the PBGC is to avoid the kind of losses we have absorbed recently. We believe that, in particular, ERISA's minimum funding standards need to be reexamined in an effort to find ways to require better funding of plans whose funding has been grossly inadequate, without imposing extra costs on sponsors of well-funded plans.

Thank you for the opportunity to appear here today. I will be happy to answer any questions you and the other members of the Committee may have.

The CHAIRMAN. Thank you very much. We appreciate your testimony.

Now these hearings today will come to a close.

[Whereupon, at 12:13 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Statement of
Air Transport Association of America to the
Committee on Finance
United States Senate
On the Administration's Tax Proposals in the FY 1988 Budget

The Air Transport Association of America (ATA) represents airlines providing more than ninety percent of the scheduled passenger miles flown and most of the air service provided in the United States.

We appreciate the opportunity to express the views and concerns of the air carrier members of ATA on several tax proposals included in the Administration's Budget for the fiscal year 1988. The proposals of significant concern are:

-- The extension of the excise taxes on air transportation that are deposited in the Airport and Airway Trust Fund;

-- The proposed $1 ticket writing charge to finance the U.S. Travel and Tourism Administration; and

-- The extension and expansion of international traveler and shipper processing fees.

Extension of the Excise Taxes on Air Transportation

Under current law, specifically Section 4261 of the Internal Revenue Code, there is an 8% tax on the purchase of domestic passenger air transportation, a 5% tax on the amount paid for the domestic air transportation of cargo and a tax of $3 for air transportation from the United States to points outside the country.

These taxes along with the taxes imposed on fuel used in non-commercial aviation provide the funds for the Airport and Airways Trust Fund to finance capital improvements to the airway system as well as to provide funding for the Airport Improvement Program. A limited portion of the current costs of operating and maintaining the airway system is also paid out of this fund.

The Trust Fund and the current taxes on air transportation were originally enacted in the Airport and Airway Revenue Act of 1970 to provide a separate and continuing source of funding for the needed improvements to the airport and airway system. The programs and the taxes expired in 1981 and were reenacted in 1982 after the administration and the Congress determined that there was an increased and continuing need for substantial improvements to the system to augment safety and capacity. These improvements, outlined in the $12 billion airport and airway reorganization and modernization effort known as the National Airspace System Plan (NAS Plan) included new computer systems and other equipment necessary to accommodate anticipated air travel growth. The NAS Plan contemplated a reliably funded multi-year spending program utilizing the Trust Fund revenues to put the equipment in place.

In order to provide the funds for the program, the Administration requested that the excise taxes on air transportation be re-enacted at the previous levels (i.e., 8%, 5% and $3, and placed in the Airport and Airway Trust Fund). Additionally, the Administration requested that a five-year program be authorized with appropriate spending levels to fund the NASP.

The air carriers and the aviation community supported the Administration's request because of the clear need to enhance system safety and increase system capacity to provide for the anticipated growth in aviation.

However, things have not gone as planned. At the end of fiscal year 1986 the Trust Fund had a cash balance of $8.6 billion and an uncommitted balance of $4.3 billion. It is estimated that at the end of Fiscal Year 1987 the uncommitted balance will be approximately $5.6 billion.

This is not the forum in which to delineate the present problems in the airport and airway system, let alone explain our concern about the systems's ability to cope with projected growth. Suffice to say, the airline industry is far from convinced that reauthorization of the existing statutory program or tax structure will resolve the underlying funding and management problems.

The Administration is asking the Congress to extend the present taxes for 2 years beyond December 31, 1987, and to reauthorize the spending programs for two years beyond September 30, 1987, when they each expire.

The air carriers believe that the taxes on air transportation should be related to authorized spending levels and ask that the Committee not make a decision on these taxes until the Congress has taken action on the spending program. In this manner the levels and duration of the taxes can be related to the planned expenditures for the airport and airway system and take into consideration the high Aviation Trust Fund surplus.

In connection with the examination of the operation and management of the airway system, a number of proposals will be considered by the Congress. The air carriers are very disturbed with the present system and will be proposing a significant change in both the funding and management of the system for the consideration of the Congress.

The ATA and its member air carriers ask that this Committee defer action on the Administration's proposal to extend the excise taxes on air transportation until the Congress has determined the future approach to airport and airway system requirements.

Proposed $1 International Ticket-Writing Charge

The Administration has proposed a $1 charge per ticket for international travel to and from the United States as a "user fee" to fund the United States Travel and Tourism Administration's current budget of $12 million. The Administration plans that receipts in excess of the current program budget will be deposited in the Treasury. The ATA estimates that such a fee applied on the same basis as the customs and INS User Fee, will raise approximately $18-20 million from airline passengers in FY 1988.

The air carriers are opposed to such a fee because it is in excess of the costs of the program and because the USTTA program benefits a large number of people, business and indeed the nation as a whole.

Foreign tourists to the U.S. visit many places and purchase goods and services throughout the country. These expenditures increase the GNP, reduce the balance of payments deficit and result in employment of a large number of U.S. citizens. The nation as a whole benefits from such a program. To identify the air carriers as the only beneficiary of the USTTA programs is clearly wrong.

Extension and Expansion of International Travel and Shipper Processing Fees

In addition to the excise taxes and the proposed $1 ticket-writing charge (discussed previously), international travelers are currently subject to a variety of user fees. Separate $5 fees are in place with regard to both Customs and Immigration processing of travelers. In addition a new $3 user fee is likely to be proposed by the Administration with reference to passenger processing by the Animal and Plant Health Inspection Service (APHIS) of the Department of Agriculture.

The airlines believe that these fees are inappropriate for three reasons:

First, the principle underlying the imposition of any user fee by the government is that a direct charge to the user is appropriate because it is the user rather than the general taxpayer who is the beneficiary of a particular service. The user pays for the service which he or she opts to receive. As such, user fees provide a convenient and appropriate means to finance specialized government services which a user elects to employ. As is noted in the Budget of the United States Government, Fiscal Year 1988, "User fees increase efficiency of service delivery by reaching those willing to pay. Cost-based user fees may also provide an incentive for the private sector to provide comparable service at a lower cost." Id. at 2-47.

We would submit that while international travelers are processed by the various law enforcement and revenue collection agencies currently charging or advocating user fees, there is no plausible argument which suggests that these passengers are somehow the beneficiaries of any governmental services which they elect to receive. The benefit of these governmental functions is clearly and directly one of utility only to the general taxpayer. As such, it is inappropriate and illogical to employ a passenger-based user fee mechanism in this context. These are general governmental expenses which should be paid for out of general revenue.

Even were one to concede that international travelers somehow benefit from Customs/Immigration/APHIS processing, the second reason the air carrier members of ATA find these fees objectionable is that, as currently structured, they bear no relationship to the government's costs for providing the processing in question.

The FY88 budget proposed by the Administration for INS, for example, would return fifty percent -- $75 million -- of the user fee charges paid by international travelers to the Treasury general fund. At the same time, of course, an effort is underway to institute a $3 APHIS user fee expected to generate $76 million while only a fraction of that amount is expended to provide the necessary APHIS inspections of international travelers.

The ATA carriers believe it is unconscionable for the government to generate substantial revenue under the guise of supposedly cost-based user fees. To the extent that any user fees are charged, we believe that the revenue must flow directly and exclusively to pay the costs of the governmental function involved.

Third, and finally, we find these fees objectionable to the extent that they were imposed with assurances of improved government capabilities for the timely and efficient processing of travelers and that improvement is not forthcoming. While it is difficult to determine from figures currently available, it does not appear that processing capabilities will be significantly improved as a result of the nearly $300 million air travelers will contribute in the form of user fees.

The Customs Service proposed budget for FY88, for example, calculates a $449 million user contribution (from both international travelers and shippers) while calling for a reduction in inspection and enforcement personnel of some 2000 full-time positions. It is difficult if not impossible to believe the passenger processing will be improved under these circumstances.

The airlines recognize that the reality of budget deficits has forced the acceptance of creative funding mechanisms for a variety of government programs. User fees are one such mechanism which, we believe, the public will accept to the extent that they are honestly employed. While we do not endorse user fees as a means of financing essential government services such as international passenger processing, we recognize that this approach provides a short-term solution to a significant problem.

We would ask that this Committee consider the following to be absolutely essential characteristics of any user fee program and that no consideration be given to the extension of any such program which does not incorporate these principles:

1. The number of user fee funded programs should be kept to an absolute minimum and the collection methods should be as simple as possible;
2. Any user fee charged must be based, as precisely as possible, on the true cost of providing government personnel and equipment to meet the particular need;
3. All user fee revenues should be dedicated exclusively to the program through which they are generated; and
4. Every effort should be expended to make user fee funded programs as efficient as possible.

We would suggest that in the absence of adherence to these principles, no consideration should be given to the extension of either the Customs or INS user fee program currently under consideration or the adoption of any new program. By the same token we do not believe that the so-called technical correction to the Custom's ad valorem cargo processing charge should not be considered favorably until such time as these principles are incorporated.

On behalf of the air carrier members of the Air Transport Association we appreciate the opportunity to submit these comments and will, of course, respond to any further questions which the Committee might wish to raise.

Statement
# of the
American Cancer Society,
American Heart Association
and the American Lung Association,
as the Coalition on Smoking or Health,
before the Senate Finance Committee

February 13, 1987

The American Cancer Society, American Heart Association and American Lung Association, together acting as the Coalition on Smoking OR Health, welcome this opportunity to comment on the President's Fiscal Year 1988 budget/revenue proposals.

As submitted, the Administration's FY 88 budget calls for approximately $22 billion in new revenues. Although one source of revenue, the cigarette excise tax, was not specifically discussed in the official budget transmittal, the Administration has recently indicated it could support an increase in this revenue source.

For example, earlier this month, Office of Management and Budget Director James Miller stated that a cigarette excise tax increase could be acceptable due to the "negative externalities" of cigarette smoking, i.e., the costs that cigarette smoking impose upon nonsmokers. This view closely corresponds with that voiced by Treasury Assistant Secretary for Tax Policy J. Roger Mentz, who, in 1986 testimony before the Senate Finance Committee, stated that excise tax increases may be justified due to the "external costs associated with the production or consumption of the taxed good." Both views are buttressed by the Council of Economic Advisors' 1988 Economic Report, which documents that past increases in the cigarette excise tax have yielded the beneficial effect of reduced consumption and the resultant effect of reduced smoking-related death and disability rates.

The American Cancer Society, American Heart Association, and American Lung Association commend the Administration for its recognition of the economic costs associated with cigarette smoking. We urge the Senate Committee on Finance to follow the Administration's lead and enact a sixteen cent increase in the federal cigarette excise tax.

The history of the federal cigarette excise tax extends over slightly more than the last century. The tax was first imposed during the Civil War at a rate of less than one cent per pack. It was increased to ten cents during Reconstruction but fell back to one cent in the late 1800s.

In the post World War II era, the federal cigarette excise tax has been increased only twice: from seven cents per pack in 1950 to eight cents in 1951, and from eight cents to its current level of 16 cents with the passage of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). It should be noted that the TEFRA increase was scheduled to expire on October 1, 1985. However, the 16 cent cigarette excise tax was made permanent with the enactment of the Consolidated Budget Reconciliation Act of 1985.

Last year, as part of its budget reconciliation package, the Senate Finance Committee reported an eight cent increase in the federal cigarette excise tax, raising the tax from its current level of 16 cents to 24 cents per pack. Unfortunately, this provision was not included in a compromise measure later adopted by the Senate.

Despite recent increases in the federal cigarette excise tax, the tax has failed to keep pace with the rate of inflation. If the 1951 eight cent cigarette excise tax had been indexed for inflation, the federal government would now be collecting 32 cents in tax revenue for every pack of cigarettes sold.

However, because the cigarette excise tax has not kept pace with inflation, tax receipts from this source have declined. Seventy-five years ago the excise tax on tobacco products accounted for approximately 20 percent of the federal government's income. In 1984, following enactment of a 16 cent federal cigarette excise tax, federal receipts from the cigarette excise tax accounted for only about 0.7 percent of federal revenues and slightly more than 0.1 percent of GNP.

While the cigarette excise tax's contribution to federal revenues has steadily declined, costs related to smoking have continued to increase. According to a 1985 Office of Technology Assessment (OTA) report, health care costs of smoking related diseases are estimated at between $11 and $35 billion per year or from three to nine percent of total U.S. health re spending costs. This includes $6.9 billion for cancers, $8 billion r circulatory system diseases, and $6.7 billion for respiratory system seases. Approximately 75 percent of these costs are incurred by ividuals under the age of 65.

federal government alone is estimated to spend between $2.3 and $6.1 lion in treating smoking-related illnesses. Annual smoking-related s incurred by the federal government include: $1.7 to $5.4 billion edicare; $0.3 to $1.1 billion by Medicaid; and $0.2 to $0.6 billion he Veterans' Administration.

m, OTA has concluded that the middle estimate for annual smoking- ed health care and lost productivity costs is $65 billion or about per pack of cigarettes (in 1985 dollars).

ent increase in the federal cigarette excise tax could help defray f the smoking-related costs now incurred by our country. But more ntly, an increase would encourage millions of young Americans to the tobacco habit. According to Kenneth Warner, Chairman of the of Public Health, University of Michigan, "an 8- to 16-cent tax would encourage from 1 to 2 million young persons and 800,000 illion adults to quit smoking or not to start."

it is for this very reason that Americans overwhelmingly support se in the cigarette excise tax. Indeed, a February 1986 poll conducted for the Los Angeles Times found that when individuals were asked, "Would you favor one of the following revenue hikes or would you rather consider some other way to raise money for the government," 81 percent of all respondents favored higher taxes on cigarettes and liquor. The next most favored alternative, a national lottery, garnered the support of only 65 percent of all respondents. Among other options 51 percent favored charging user fees; 45 percent favored higher tariffs on imported oil; 36 percent favored higher gasoline taxes; 31 percent favored a national sales tax; 24 percent favored an increase in income taxes; and 10 percent favored charging more for Medicare.

Similar results were obtained in a poll conducted for TIME in February 1984 in which 77 percent of respondents supported an increase in the tax on tobacco as a means of reducing the federal deficit.

The primary concern voiced by those who have opposed an increase in the cigarette excise tax is the impact such action will have on America's poorer citizens who happen to smoke. Yet, because the majority of smokers smoke less than one pack of cigarettes per day (the 1983 Surgeon General's report found that 65 percent of all male smokers and more than 75 percent of all female smokers smoke less than 24 cigarettes per day), the impact of a 16 cent increase in the cigarette excise tax on these individuals would be slightly more than $1 per week. This should be compared to the OTA's conclusion that the health care and lost productivity costs attributable to cigarette smoking average $2.17 per pack or more than $15 per week for the majority of smokers.

Recently, Senator John Chafee introduced S.447, which would increase the federal cigarette excise tax from its current level of 16 cents to 32 cents per pack. The Chafee proposal would also increase the tax now imposed on chewing tobacco and snuff from its current rate of about 1.5 cents per package to eight cents per package.

Revenue returns to the federal government from an increase in the excise tax on smokeless tobacco will not be as significant as the anticipated returns from an increase in the cigarette excise tax. Nonetheless, the impact such a tax increase could have on use patterns justifies enactment of the Chafee proposal.

The tobacco industry is currently enjoying great success in marketing smokeless tobacco products, primarily moist snuff, to our nation's youth. The 1986 Report of the Advisory Council to the Surgeon General on the Health Consequences of Using Smokeless Tobacco found that 12 million Americans used some form of smokeless tobacco during 1985, including 16 percent of males between 12 and 25 years of age. The Committee found that in several parts of the country as many as 25 to 35 percent of adolescent males indicated current use of tobacco products.

Yet, the dangers associated with smokeless tobacco products are every bit as great as the dangers associated with cigarette smoking. Smokeless tobacco products have been linked to cancer, periodontal bone destruction, tooth abrasion, and gingival recession. The Americans

Cancer Society estimates that ten percent of the 9,500 oral cancer deaths that occur in this country are attributable to smokeless tobacco.

Young children are reported to be the most price sensitive of consumers. Although responsiveness to price varies, most agree that, on average, younger persons have less disposable income making their demand for tobacco products quite elastic. An increase in the price of smokeless tobacco products, which would result from an increase in the federal excise tax on these products, could therefore be expected to produce reduced consumption of these products among America's youth.

The American Cancer Society, American Heart Association, and American Lung Association believe that a sixteen cent increase in the federal cigarette excise tax as well as an increase in the excise tax on smokeless tobacco products to 8 cents per pack will yield major long turn health benefits for our nation while producing more than $9 billion in new federal revenues. We urge the Senate Finance Committee to adopt S.447 as a major health promotion and deficit reduction measure.

STATEMENT OF THE
AMERICAN PETROLEUM INSTITUTE
SUBMITTED TO THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

REGARDING
HEARINGS ON ADMINISTRATION TAX PROPOSALS

WASHINGTON, DC
FEBRUARY 13, 1987

Introduction

Among the revenue initiatives included in the President's fiscal year 1988 budget proposals is the repeal of the Crude Oil Windfall Profit Tax ("WPT"). The American Petroleum Institute ("API") strongly endorses the repeal of the WPT. The WPT is bad tax policy and worse energy policy.

First, the WPT is contrary to the national interest in reducing energy dependence. It serves as a disincentive to investment in domestic petroleum resource development at the very time the government is seeking ways to contain growing dependence.

Second, the petroleum industry's federal tax burden without WPT already has been greater than that of non-oil companies. A special tax on the petroleum industry is, therefore, unfair and, in light of domestic security concerns, ill-advised.

Third, the WPT is inefficient because it continues to impose a heavy administrative burden on both government and taxpayers despite the fact that it is generating no revenues. Under the Administration's current price projections, the repeal of the WPT would have no revenue impact in 1988, or at any time prior to 1991, the year when the tax is to begin phasing out under current law. Since the WPT generates no revenues, these compliance efforts generate pure economic waste.

Fourth, the WPT has served its original purpose of capturing a substantial portion of the revenues from price decontrol. There are simply no "unearned profits" from decontrol to be taxed.

THE CURRENT DOMESTIC ENERGY SITUATION

Any discussion of the repeal of the WPT must begin with a background discussion of the current domestic energy situation. This discussion will provide the appropriate framework for analyzing the WPT.

Early last year the price of oil plummeted and then drifted further downward for several months. Although the price has recovered somewhat from the low levels it reached last summer, it still is about one-third below its level in late 1985.

The price fall has set in motion forces that, if unchanged, will substantially increase the oil dependence of the United States on foreign suppliers, greatly strengthen the cartel power of the Organization of Petroleum Exporting Countries ("OPEC") and result in serious economic and national security costs.

Recent Trends in Oil Consumption, Production, and Imports

The price of oil rose sharply in 1973-1974 during the Arabian oil embargo and again in 1979-1980 in connection with the Iranian supply disruption. The price peaked in 1981, then fell by about one-quarter by 1985. Last year saw another sharp decline, bringing the price back to about the 1978 level.

The reactions to the price hikes of the 1970s provide important insights into the likely course of events in oil markets over the next few years. These insights are important because many people in the 1970s underestimated the demand and supply responses to higher oil prices, and many today similarly seem to be underestimating the likely responses to lower oil prices.

In the late 1970s, largely in reaction to previous oil price increases, U.S. oil consumption began to fall and production to rise. Consequently, U.S. net imports of oil fell from their peak of 8.5 MMBD in 1977 to 4.1-4.5 MMBD during the 1982-1985 period. Net imports were reduced from 46.4 percent of total consumption in 1977 to 26.5 percent of consumption in 1985.

Moreover, studies have shown that consumer and producer responses to higher oil prices would have been even greater were it not for U.S. price controls, which limited the prices of domestically produced crude oil and oil products until 1981, and the WPT which continued to prevent U.S. oil producers from obtaining the full benefits of the world price.[1]

Outside the U.S., oil consumption fell substantially after 1979, while oil supplies were augmented by newly developed non-OPEC sources such as the North Sea, Mexico and Egypt. As a result of decreased oil import demand both in the U.S. and in the rest of the free world, demand for OPEC oil dropped by about 14 MMBD, or 45 percent, between 1979 and 1985. After Saudi Arabia increased its output in late 1985, the price of oil collapsed.

U.S. oil consumption and production at first responded sluggishly to the $10 per barrel price drop that occurred in January 1986. But as prices remained low, consumption began to increase and production to decrease more rapidly. By the fourth quarter of 1986, consumption had risen about 4 percent above the year-earlier level, while production had fallen about 7 percent below the year-earlier level. By the end of the year, production was about 9 percent below its February peak. Consequently, net oil imports in 1986 rose substantially, reversing an 8-year downward trend in U.S. reliance on oil imports. For 1986 as a whole, net oil imports accounted for 32.5 percent of total oil consumption, up from 26.5 percent in 1985.

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[1] See Joseph P. Kalt, The Economics and Politics of Oil Price Regulation in the Post-Embargo Era, Massachusetts Institute of Technology Press, 1981; and American Petroleum Institute, Domestic Petroleum Production and National Security, December 1986.

Lower oil prices also have affected oil consumption and production outside the U.S. Non-U.S. consumption was up about 2 percent in 1986, compared with an average annual decline of about one percent during the previous three years. On the supply side, although oil production in free world, non-OPEC nations outside the U.S. was up about one percent in 1986, this increase was far smaller than the 6 percent average annual gain in the previous three years.

The rise in imports in the U.S. and the rest of the world is expected to lead to a change in world petroleum market conditions. About three-quarters of the free world's oil reserves are held by OPEC countries. Further, Saudi Arabia and the other Persian Gulf nations alone hold 65 percent of the world's current surplus oil production capacity while OPEC as a whole holds 95 percent. This means that rising world consumption largely will be supplied by OPEC countries, strengthening OPEC's ability to establish and maintain production and pricing discipline among its members.

Effect of Higher U.S. Oil Imports on the World Oil Price

Although there are considerable differences of opinion about the future behavior of the OPEC cartel, from past experience the most likely scenario is that OPEC will increase oil prices when the world oil market tightens significantly.

Estimates of OPEC's current and likely future capacity vary somewhat. It appears likely, however, that worldwide demand for OPEC oil will raise OPEC's capacity utilization rate from its current level of about 60 percent or so to over 80 percent within a few years. It will require only about a 6 MMBD increase in demand for OPEC oil to bring OPEC's capacity utilization to 80 percent, and most analysts foresee such an increase within a few years.

There is an historical relationship between OPEC capacity utilization and changes in world oil prices. Based upon this "reaction function," which was developed initially by the U.S. Department of Energy ("DOE") from analysis of OPEC's past behavior, and assuming a base oil price between $15 and $25 per barrel (in 1984 dollars), a one MMBD increase in the demand for OPEC oil is estimated to raise the world oil price by $1.04-$1.74 per barrel if OPEC capacity utilization is 80 percent, and by $5.35-$8.91 per barrel if OPEC capacity utilization is 90 percent.

Disruption Costs

Concentration of oil supplies ~~in a~~ politically unstable area like the Middle East increases the risks of a supply disruption. The U.S. can mitigate the impact of an unfavorable Middle Eastern development on the world oil price, however, by reducing its demand for imported oil, thereby creating greater slack in world oil markets.

A disruption has the direct effect of transferring wealth from oil-importing to oil-exporting nations. In the current context, a cutback in foreign oil production that caused the oil price to rise by $10 per barrel would transfer from the U.S. some $20 billion per year, or about one-half of one percent of the U.S. gross national product ("GNP").

In addition to the wealth transfer effects of an oil supply disruption, researchers have estimated substantial indirect costs. Econometric estimates of the overall macroeconomic effects of supply disruptions have been much larger than the direct wealth transfer effects. For example, simulations utilizing the macroeconomic models of Data Resources Inc., Wharton Econometric Forecasting Associates, and Lawrence H. Meyer Associates performed for the National Petroleum Council indicate that the 1973-1974 oil price jump reduced the U.S. GNP by about 2.5 percent within three years, while the 1979 price jump reduced U.S. GNP by about 3.5 percent within three years. And, current estimates indicate that a large world oil supply shortfall of say 10 MMBD could reduce the U.S. GNP by as much as 7 percent.

As the U.S. becomes more dependent on imported oil, the potential costs of a supply disruption will rise. Therefore, to the extent that low oil prices today increase U.S. import dependence, they create the potential for higher disruption costs.

National Security Implications of Increased U.S. Oil Import Dependence

Besides the economic costs of increased reliance on OPEC oil, such reliance can impose military and foreign policy burdens on the U.S. and other oil-importing nations. In brief, because of dependence on oil imports from the Middle East, the U.S. and other oil importers may have to make military commitments and adopt foreign policies that they might not otherwise choose.

The Effects of the Oil Price Fall on the Domestic Oil Industry

The fall in oil prices since 1981 has had a devastating impact on U.S. petroleum companies and on their financial ability to search for and develop petroleum resources. The aggregate net income of leading U.S. oil companies fell by almost 50 percent between its 1981 peak and 1985. The earnings decline accelerated in 1986 during which net income fell by about 25 percent. The

1986 earnings decline for the leading oil companies, which are integrated concerns with refining, marketing, and transportation operations as well as oil production, was ameliorated by their downstream operations which generally did better than oil production. Independent producers fared even worse than the major integrated companies. An Oil & Gas Journal (October 27, 1986) survey of 170 independent producers indicated that they had an aggregate loss of about $3.5 billion in the first half of 1986, as compared with a profit of almost that size in the first half of 1985.

The fall in oil prices and consequent decline in profitability since 1981 caused a sharp reduction in petroleum exploration and development. Domestic exploration-production capital expenditures by the leading oil companies decreased by about 25 percent between 1981 and 1985. Such expenditures during the first three quarters of 1986 (the latest data available) fell about 40 percent from their level in the comparable period of 1985. And, expenditures in the third quarter of 1986 were down even more -- by 55 percent -- from their year-earlier level.

The number of rotary drilling rigs active in the U.S. fell from a high of about 4,500 in late 1981 to about 1,900 by year-end 1985. The rate of decline also accelerated in 1986, and the active rig count recently has only been about 900.

Consequently, the number of wells completed in the U.S. decreased after 1981, falling by about 19 percent by 1985. Estimates for 1986 indicate that well completions again fell, by more than 25,000, or nearly 40 percent. This is the largest annual decline on record.

Federal Energy Policy

A healthy domestic petroleum industry can be the buffer against U.S. vulnerability to oil price shocks and supply disruptions. Federal energy policies which potentially could improve U.S. energy security should begin with removing impediments to domestic production. The WPT is one such impediment.

REPEAL OF THE WINDFALL PROFIT TAX

The WPT is an excise tax on the so-called windfall profit element of the price of domestic crude oil. Generally, the so-called windfall profit element is the excess of the sale price over the adjusted (for inflation) base price.

(1) The WPT is a disincentive to domestic production.

Although total revenues from the WPT have been much less than what was originally estimated, the tax has nonetheless represented a significant disincentive to domestic exploration and production. And, even though under current depressed industry conditions little or no WPT is being levied, the tax poses a disincentive to both present and future investment because it limits the potential profitability from any future increases in oil prices.

The negative influence of the WPT occurs in two ways. First, the WPT imposes an economic disincentive on new production, thus making many new domestic oil exploration and production projects unattractive. For example, more intensive development of existing fields (infill drilling, secondary recovery operations, pressure maintenance operations, and workovers, e.g.) is especially sensitive to the WPT. These projects have offered and continue to offer the best opportunity for near-term supply response. Thus, continuation of the tax would result in less domestic production and an inevitable increase of oil imports. Second, because of the high risk nature of the business, internally generated cash flow, rather than borrowings, must provide a major source of exploration and production capital. This cash flow is generated largely by income from existing production (e.g., Tier 1 old oil) that must carry the principal burden of funding new projects. However, the WPT extracts the largest cash-flow penalty from this production. This design flaw of the WPT decreases the pool of capital available to fund exploration and development by reducing the cash flow generated by existing production.

Additionally, the very structure of the WPT with its different tax rates and adjusted base prices fosters distortion in investment decisions. For example, in today's environment and over the foreseeable future, any WPT that is due will be from Tier 1 crude oil. A barrier is thus erected to new investment on Tier 1 properties and otherwise recoverable reserves are left in the ground. The trend toward shutting in wells is exacerbated by continuation of the tax. Repealing the WPT would do away with these artificial distinctions, and reduce such misallocations of resources.

(2) The WPT is inequitable because the petroleum industry already bears a tax burden higher than that of other industries even without the WPT.

For 1985, the latest year for which data is available and for which significant WPT was due, the API found that 20 leading oil companies paid WPT and federal income taxes at a rate of 36 percent of pre-tax domestic net income. This figure is 50 percent greater than that of 100 leading non-oil companies (36 percent vs. 24 percent). For 1980 through 1985, the average federal tax burden for oil companies was 43 percent while for non-oil companies, it was 23 percent.

The federal income tax burden calculated as it would be if there were no WPT also was higher for oil companies than for non-oil companies in each year of the 1980-85 period. By this measure, the oil company tax rate in 1985 was 26 percent while that for non-oil companies was 24 percent.

Similarly, even if the income tax rates of oil and non-oil companies are calculated without adjustment for the WPT, a misleading comparison at best, federal income taxes paid by oil companies during 1980-1985 represented the same percent of pre-tax domestic net income as that of non-oil companies.

In sum, the evidence is that the petroleum industry's rate of federal tax payments has been as high or higher than that of non-oil industries even in the absence of the WPT and much higher if that tax is included. Futhermore, if Joint Tax Committee estimates of additional burdens placed upon petroleum in particular and industry in general are correct, the oil industry's federal income tax burden can be expected to increase even further under the Tax Reform Act of 1986. That provides additional reason for repealing the tax. In testimony before the Finance Committee February 4, 1987, J. Roger Mentz, Assistant Secretary of the Treasury, noted that the Tax Reform Act was "...designed to produce uniform rates of taxation on the income generated in different activities, and to eliminate tax-induced distortions in investment. Repeal of the windfall profit tax is consistent with that objective."

(3) The tax has become inefficient because of the collection effort vs. revenue disparity.

Failure to repeal the WPT will undoubtedly serve to worsen the situation for an industry now struggling to survive the most serious depression of its history. The administrative costs are substantial. The cost to taxpayers is at least as great as the cost to government. It is simply a drain on public funds to continue a tax that costs the government more to administer than it returns in revenues.

This situation is not likely to change in the near future. According to the Joint Committee on Taxation, average adjusted base prices are now $18.49 to $19.07 for Tier 1, $20.89 for Tier 2 and $23.11 to $27.59 for Tier 3 crude oil. Little, if any, WPT is expected to be due in the coming months. The Administration's 1988 budget shows a revenue loss for the WPT for fiscal 1987. Based on the Congressional Budget Office's most recent forecast of petroleum prices, the WPT will raise little or no revenue over the next five years. The Administration's forecasts show that the repeal of the WPT will have no revenue impact at any time prior to 1991.

Meanwhile, despite the price collapse and consequent "suspension" of WPT payments, tax returns and other reports still must be filed, accounting records maintained and efforts to devise a workable system pursued. For example, there is a monstrous administrative burden associated with Form 6248 which purchasers must file with both the producer and the IRS. Hundreds of thousands of these forms must be filed annually, and they must be filed for all transactions even if no WPT is due.

Moreover, for the years in which the WPT has been in effect, taxpayers and the government have struggled to resolve complicated legal and accounting questions. Unfortunately, far too many of these questions still are unresolved. This tax has turned out to be much more complex and require many more filings from many more taxpayers than was envisioned at enactment.

There is also the confusion that continues to exist because DOE pricing and allocation regulations were used as the basis for many features of the tax. Besides the confusion inherent in applying now otherwise defunct DOE concepts, often the regulations were issued to achieve an entirely different goal from that of the IRS.

Finally, there is the cost to the government of time devoted to regulatory projects that result in the kind of problems seen in the intermediate disburser regulations. Not only is there substantial time spent in drafting the regulations, even more is spent as the IRS staff tries to revise the regulations in response to public comments. The taxpayers bear a similar, if not greater, cost as they attempt to comply with regulations or furnish the IRS with explanations of why an approach should be modified. Despite these efforts, very few technical questions have been resolved almost seven years after the enactment of the tax. Indeed, it appears that many issues will, of necessity, be resolved through costly litigation.

(4) The tax has served its original purpose; there are no longer any "unearned profits" from decontrol to be taxed.

When President Carter announced his plan for phased decontrol of domestic crude oil prices on April 5, 1979, he also proposed a tax on the "windfall profit" of producers and royalty owners to "...prevent unearned, excessive profits which the oil companies would receive as a result of decontrol and possible future OPEC increases...".

The original purpose of the WPT has been achieved--a substantial portion of the revenues from decontrol has been captured by the federal government. However, since the precipitous decline in crude prices, the prices have dropped below the controlled ceiling prices that would have existed had price controls still been in effect. There are simply no "unearned, excessive profits" to be captured.

Since President Reagan accelerated and completed decontrol in 1981, domestic crude oil has been produced and sold in direct competition with crude oil from other producing nations. Domestic crude oil prices have been determined by the forces of the world market. Because the market in which the domestic petroleum industry now operates is working, with prices both rising and falling in response to supply and demand, there is no reason to continue the tax surrogate for the price controls in effect a decade ago. That the market works is shown by the price collapse which occurred when worldwide production exceeded worldwide demand. Continuing the WPT disadvantages the domestic petroleum industry without accomplishing the purposes for which it was enacted.

These circumstances have been recognized by the Administration. As stated by Assistant Treasury Secretary Mentz in his February 4 testimony, "[E]ven if crude oil prices again rise to levels that would generate significant profits for domestic oil producers, such profits would, in no way, be considered 'windfall' profits. This is because a return to a profitable situation for domestic oil producers would be the result solely of market conditions (here and abroad) and not the result of the government lifting an artificial price barrier, as was the case when the tax was first imposed."

Conclusion

The WPT is contrary to the national interest and should be repealed immediately. It discourages investment in domestic petroleum production at a time when dependence on foreign imports is rising rapidly. It constitutes an additional tax burden on an already heavily taxed industry. Even under present distressed industry conditions when the tax generates no revenues, it continues to impose heavy compliance and administrative burdens on both taxpayers and government. And, it has served its purpose of capturing a portion of the domestic income transfer associated with the decontrol of domestic crude oil prices. There are simply no "unearned profits" from decontrol to be taxed.

If the nation is to benefit from the full potential increase in domestic supply in response to any future price recovery, the result of that price rise must be permitted to flow through to the industry.

The cost of exploring for and producing crude oil is likely to continue to increase, especially since the best domestic prospects are generally in difficult or hostile environments such as Alaska or deep-water Gulf of Mexico. Removing an impediment to investment such as the WPT will be one step towards restoring health to the domestic petroleum industry and towards slowing reliance on imported crude oil.

Statement of
The Associated General Contractors of America
Presented to the
Committee on Finance
United States Senate
on the Subject of
Revenue Increases Proposed
in the President's Budget
February 11, 1987

AGC is:

- More than 32,500 firms including 8,400 of America's leading general contracting firms responsible for the employment of 4,000,000-plus employees;
- 106 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities

The Associated General Contractors of America represents more than 32,500 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 4,000,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities.

This statement of the Associated General Contractors of America speaks to the following two proposals contained in the President's budget:

1. Repeal of current law exemptions from the gasoline, diesel fuel and other highway excise taxes; and

2. Extension of the excise taxes that finance the Airport and Airway Trust Fund.

1. Repealing Exemptions from the Federal Fuel Tax

AGC has long called for an end to the current tax exemption for gasohol. AGC strongly believes that subsidizing the gasohol industry at the expense of the nation's highways and bridges is not sound public policy. It violates the user fee principle of the highway program, and the Highway Trust Fund simply cannot afford it. If the gasohol industry must continue to be subsidized, the subsidy should come from general revenues. A vehicle powered by gasohol contributes to the wear and tear of our highways and bridges the same as a vehicle powered by gasoline or diesel fuel. Both vehicles should pay their fair share of highway user fees.

AGC's opposition to the gasohol tax exemption was reinforced in August 1986, when the Agriculture Department's Office of Energy released a report entitled "Fuel Ethanol and Agriculture: An Economic Assessment" which contained the following findings:

o The ethanol industry cannot survive without massive Government subsidies, given the outlook for petroleum prices. Costs of producing ethanol in 1986 were \$1.41-\$1.52 per gallon while the wholesale price of gasoline was \$0.55 per gallon.

AGC believes that the gasohol exemption seriously undermines the user fee base of the Highway Trust Fund. Gasoline and diesel users are subsidizing highway use by gasohol users. The large federal subsidy goes to a relatively few gasohol producers. In fact, the Federal Highway Administration estimates that about half the production is from one domestic producer.

The current exemption for gasohol significantly reduces revenues going into the Trust Fund. In fiscal year 1987, the Federal Highway Administration estimates that the loss will amount to approximately \$450 million, and by fiscal year 1991 the loss would increase to approximately $510 million. The gasohol exemption is of particular concern since gasohol is being supported by general exemptions from both federal and state highway user taxes and the Agriculture Department's corn subsidy program for ethanol producers. Taken in combination, AGC estimates that government subsidies total about $1.28 per gallon of ethanol--60 cents federal gas tax subsidy, 30 cents average state gas tax subsidy, and 38 cents corn program subsidy. With ethanol currently selling for about $1.00 per gallon, government subsidies therefore exceed the price of the product by over 25 percent.

The gasohol exemption provided by the federal government has also been adopted by states. State revenue losses due to gasohol exemptions are estimated at over $300 million in 1985. The combined federal and state revenue loss was nearly $750 million in 1985. Because of this severe drain on revenues, states have begun to restrict the gasohol exemption. In the last year, 12 states eliminated, reduced, or restricted their exemptions.

Removal of the gasohol exemption is an issue on which there is nearly unanimous agreement among highway users. The projected loss from this exemption of several billion dollars in federal and state highway revenue over the next few years is viewed as a most serious problem by all those concerned with maintaining a good highway system. The removal of the gasohol exemption would provide close to one-half billion dollars a year in much-needed revenues to the Highway Trust Fund.

Accordingly, AGC urges the Finance Committee to report out legislation repealing the current fuel tax exemption for gasohol.

2. Extension of the User Taxes Supporting the Airport and Airway Trust Fund

The situation facing our nation's airport and airway system is becoming critical. According to the Federal Aviation Administration, more than 650 million passengers are expected to fly on scheduled commercial airlines each year by 1997. This represents an astounding 66 percent increase from the 391 million passengers which the FAA estimates flew on commercial airlines in 1986.

During the same time period, the country's civil aircraft fleet is expected to grow to more than 250,000, as air carriers increase their fleets by about 1,000 airplanes to meet the anticipated demand for air travel, and as another 30,000 general aviation aircraft come into operations.

The availability of safe and efficient air transportation depends largely on the continued investment in airport capital development. This will require lengthening and strenghtening runways and building new terminals, gate space, hangars and service facilities. The FAA estimates that a total of $24.3

billion in capital development will be required through 1995 to meet the increases in demand for air travel. However, the FAA's estimate includes only the costs of those projects that are eligible to receive federal funding. A more realistic assessment of the total capacity improvement needs is provided by the American Transportation Advisory Council in its ATAC-III report. According to the report, "at least $27 billion will be needed to fund the required capital improvements in the nation's airports over the period 1987-1995."

Notwithstanding the concern over the federal budget deficit, it must be emphasized that the Airport Improvement Program and the other federal aviation programs are financed entirely from the Airport and Airway Trust Fund. The Trust Fund is supported by the 8 percent airline ticket tax and other fees collected from the users of our aviation system in keeping with the sound fiscal policy that users of the system should be the ones to pay the costs. This "pay-as-you-go" system has worked successfully.

Moreover, the monies that have been spent on our nation's airport and airway system have never contributed a penny to the federal deficit. User fees are collected from the nation's aviation users, placed in the Airport and Airway Trust Fund and dedicated, by law, to be spent on the nation's airport and airway system. The Airport and Airway Trust Fund is in reality a very simple and efficient balanced budget account.

Accordingly, AGC urges the Finance Committee to report out legislation extending the Federal government's authority to continue collecting the 8 percent airline ticket tax and the other aviation user taxes beyond their December 31, 1987 expiration date.

Removing the Airport and Highway Trust Funds from the Federal Unified Budget

AGC also supports removing the Highway and Airport Trust Funds from the federal unified budget. The Highway and Airport Trust Funds are self-supporting since all of their resources come from user fees paid by users of the transportation system, not the general taxpayer. The amount paid in depends on the extent of the use by the individual user. The dedicated funds cannot be used for purposes other than transportation improvements as provided by law. Any budget-enforced "savings" cannot be used to fund other programs.

Unlike open-ended entitlement programs, highway and aviation spending is limited by authorization legislation regularly passed in both houses and signed into law. These authorizations, unlike those for general-funded programs, amount to far more than a mere "hunting license" for appropriations up to a given level. The authorizations provide contract authority, a form of direct spending authority comparable to appropriations. Accordingly, they receive the same degree of scrutiny as appropriations acts and can be relied upon to provide the same degree of fiscal restraint as is provided by appropriations acts in the case of general fund programs.

In 1983, the Congress moved the Social Security trust fund off budget, effective in 1992, so as to base decisions affecting the program on the soundness of the trust fund rather than budget-wide considerations. These transportation trust funds are far more deserving of this treatment because they support regularly authorized programs. They are totally self-financed. They are deficit-proof and have performed well for years.

Accordingly, AGC encourages the Finance Committee to support removal of the Highway and Airport Trust Funds from the federal unified budget.

City of Baldwin Park
CIVIC CENTER
14403 EAST PACIFIC AVENUE • BALDWIN PARK, CALIFORNIA 91706
TELEPHONE 960-4011

February 9, 1987

Senator Lloyd Bentsen
Chairman
Senate Finance Committee
205 Dirksen Senate Office Building
U.S. Senate
Washington, D.C. 20510

Dear Senator Bentsen:

The City of Baldwin Park is strongly opposed to a provision of the President's fiscal 1988 budget that would extend the Medicare part of the Social Security tax to all state and local government employees.

Should the Medicare tax become effective January 1, 1988, as proposed in the President's budget, the City of Baldwin Park would have to pay $71,624.00 out of a total payroll of $6,437,100. Medicare costs would double to $143,248 if the City were required to pay the employees' share of the Medicare tax as a result of a collective bargaining agreement. This would result in the City paying up to 2.9% of their payroll toward the Medicare tax.

Congress has repeatedly rejected efforts to extend mandatory Medicare coverage to all state and local government employees. The Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 included a commitment from Congress to adopt a gradual phase-in of mandatory Medicare coverage, and to impose coverage only on newly hired state and local government employees. The reason for a phase-in was to allow municipalities time to absorb the costs gradually, thereby avoiding the need to jeopardize employee benefit plans already in place. Abrogating such a commitment is clearly not exercising the intent of Congress when it passed COBRA, and would cause excessive financial strain on municipal budgets, as well as increased benefit premiums for state and local employees.

The City is already faced with proposals in the President's fiscal 1988 budget that call for draconian cuts or elimination in many municipal programs, and more costly federal mandates. For example, Economic Development Administration grants, Section 108 loans, and the Urban Development Action Grant program would be eliminated, and deep cuts are proposed for public transportation and highway funding, as well as housing programs. In addition to these cuts in vital municipal programs, the City is also forced to deal with the loss of the Federal Revenue Sharing program which expired last year.

We recognize the difficult problems Congress faces in dealing with the severe spending targets of the Gramm-Rudman balanced budget law and realize the need to control federal spending. However, we do not believe that revoking a commitment to state and local governments is the appropriate response to the deficit dilemma. As such, we ask for your support to reject any proposal that would extend mandatory Medicare coverage to all state and local government employees.

Sincerely,

Jack B. White

Jack B. White
Mayor

CML

COLORADO MUNICIPAL LEAGUE
1500 Grant Street, Suite 200
Denver, Colorado 80203
phone (303) 831-6411

February 12, 1987

William J. Wilkins
Committee on Finance
Room SD-205
Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Wilkins:

This letter is being submitted as a written statement for inclusion in the printed record of the hearing on the Administration's tax proposals.

The Colorado Municipal League on behalf of its 243 member cities and towns opposes those portions of the President's budget for fiscal year 1988 which (1) mandatorily extend the medicare portion of social security to all state and local employees, and (2) repeal current exemptions for the state and local governments from the federal highway excise taxes. The League strongly objects to both proposals because of their adverse financial impact on local government and because the federal budget should not be balanced at the expense of local governments and local taxpayers.

Mandatory Medicare Coverage

Requiring all public employers and employees to contribute to the medicare portion of social security will be very expensive for state and local governments. We have estimated the cost to Colorado municipalities to be approximately $3.74 million annually. Enclosed is a table which describes in more detail this impact. Of course, the cost to Colorado generally will be much greater because of the many state and school employees affiliated with PERA who are not covered by social security. Congress dealt with this issue adequately in 1985 when mandatory medicare coverage was enacted for employees hired after 1985. This approach, while ultimately expensive to state and local governments, substantially reduced the adverse fiscal impact through a phase-in process. We urge Congress to stick with its 1985 phase-in legislation and to oppose the President's proposal.

Repeal of the State and Local Exemption from Federal Highway Excise Taxes

The President's proposal to repeal state and local exemptions from federal highway excise taxes would be most unfair as well as impose another financial burden on state and local governments. The tradition in this nation has been to exempt each level of government from taxes imposed by the other levels. There is solid reason for continuing this tradition of reciprocal immunity. In addition to the cost implications of the President's proposal, it is ironic and disturbing that the federal government would remain exempt from state and local highway excise taxes! We hope Congress will treat state and local governments fairly and reject the Administration's proposal.

In conclusion, we ask for your support on budget issues by treating state and local governments fairly and avoiding the temptation of balancing the federal budget through transferring costs to state and local governments.

Sincerely,

Kenneth G. Bueche
Executive Director

PREPARED BY: Colorado Municipal
League
Dec. 15, 1986

ESTIMATED COSTS FOR COLORADO MUNICIPALITIES FOR MANDATORY MEDICARE AND SOCIAL SECURITY

		in $ millions
1987 Mandatory Medicare		
Police/Fire (all municipalities)	$2.34	
General Employees (municipalities without Medicare)	1.40	
Total		$3.74
1987 Social Security		
Police/Fire (all municipalities)	9.20	
General Employees (municipalities without Social Security)	5.50	
Total		14.70
1987 MANDATORY MEDICARE PLUS SOCIAL SECURITY		$18.44
1988 Mandatory Medicare		
Police/Fire (all municipalities)	2.34	
General Employees (municipalities without Medicare)	1.40	
Total		3.74
1988 Social Security		
Police/Fire (all municipalities)	9.78	
General Employees (municipalities without Social Security)	5.90	
Total		15.68
1988 MANDATORY MEDICARE PLUS SOCIAL SECURITY		$19.42

NOTE: The above figures are rough estimates. The figures may be understated since: 1) figures used for police/fire estimates do not include amounts for municipalities under 2,000 population; 2) no increases in salaries have been built in, and in some instances, 1984 data was used; 3) salaries for police/fire were estimated as 50 percent of current police/fire expenditures and may actually be greater than 50 percent. The figures may be overstated since a few smaller municipalities already have social security for police/fire personnel.

Estimated cost of mandatory medicare and mandatory social security

Total Police/Fire current expenditures in 1984 for all Colorado municipalities of over 2,000 population *	$322,785,100 =	$322.8 million
Assuming 50% of current police/fire expenditures during 1984 were for police/fire salaries		161.4 million
times .0145 mandatory Medicare	x	.0145
Estimated total cost for mandatory Medicare in 1987 for police and fire personnel	=	$ 2.34 million
		$161.4 million
times .057 mandatory social security	x	.057
Estimated total cost for mandatory Social Security in 1987 for police and fire personnel	=	$ 9.20 million
1987 MANDATORY MEDICARE PLUS SOCIAL SECURITY FOR POLICE AND FIRE PERSONNEL	=	$ 11.54 million
Estimated 1988 police/fire salaries		161.4 million
times .0145 mandatory Medicary	x	.0145
Estimated total cost for mandatory Medicare in 1988 for police and fire personnel		$ 2.34 million
		161.4 million
times .0606 mandatory social security in 1988	x	.0606
Estimated total cost for mandatory Social Security in 1988 for police and fire personnel	=	$ 9.78 million
1988 MANDATORY MEDICARE PLUS SOCIAL SECURITY FOR POLICE AND FIRE PERSONNEL	=	$ 12.12 million

plus

Estimated costs for mandatory medicare and mandatory social security for personnel, other than police/fire, for those municipalities on the attached list which do not have FICA or Medicare coverage for "general" employees

Estimated total salaries, not including police/fire		$ 97.3 million
times .0145 mandatory Medicare	=	1.4 million
times .057 mandatory social security in 1987	=	5.5 million
1987 MANDATORY MEDICARE PLUS MANDATORY SOCIAL SECURITY	=	$6.9 million
times .0145 mandatory Medicare	=	1.4 million
times .0606 mandatory social security in 1988	=	5.9 million
1988 MANDATORY MEDICARE PLUS MANDATORY SOCIAL SECURITY	=	$7.3 million

Colorado

Cities/towns without FICA	Pop.	Full-time empl.	Est. total salaries*	1987 Est. Medicare cost (salaries x 1.45%)	1987 Est. Soc. Sec. cost (salaries x 5.7%)	1987 Estimated Total cost	1988 Est. Soc. Sec. cost (salaries x 6.06%)	1988 Estimated Total cost
Alamosa	6,985	72	1,440,000	20,880	82,080	102,960	87,264	108,144
Arvada	89,032	457	9,140,000	132,530	520,980	653,510	553,884	686,414
Avon	1,130	28	684,168	9,920	38,998	48,918	41,461	51,381
Bayfield	872	6	120,000	1,740	6,840	8,580	7,272	9,012
Boulder	79,738	761	25,530,671	370,195	1,455,248	1,825,443	1,547,159	1,917,353
Brighton	13,845	103	2,060,000	29,870	117,420	147,290	124,836	154,706
Cheyenne Wells	1,146	4	80,000	1,160	4,560	5,720	4,848	6,008
Collbran	366	4	80,000	1,160	4,560	5,720	4,848	6,008
Colorado Springs	251,091	3,476	42,676,314	618,807	2,432,550	3,051,356	2,586,185	3,204,991
Craig	9,320	83	1,923,064	27,884	109,615	137,499	116,538	144,422
Crawford	255	2	40,000	580	2,280	2,860	2,424	3,004
Crested Butte	940	15	300,000	4,350	17,100	21,450	18,180	22,530
Durango	12,633	160	4,274,407	61,979	243,641	305,620	259,029	321,008
Fort Morgan	8,934	115	2,300,000	33,350	131,100	164,450	139,380	172,730
Lafayette	12,407	92	2,142,431	31,065	122,119	153,184	129,831	160,897
Lakewood	120,001	639	18,348,872	266,059	1,045,886	1,311,944	1,111,942	1,378,000
Lamar	8,500	165	2,777,701	40,277	158,329	198,606	168,329	208,605
Las Animas	2,718	36	511,497	7,417	29,155	36,572	30,997	38,413
Longmont	49,050	588	11,760,000	170,520	670,320	840,840	712,656	883,176
Manitou Springs	5,039	50	1,163,745	16,874	66,333	83,208	70,523	87,397
Mt. Crested Butte	316	12	240,000	3,480	13,680	17,160	14,544	18,024
Northglenn	30,421	210	5,389,015	78,141	307,174	385,315	326,574	404,715
Parker	454	16	386,404	5,603	22,025	27,628	23,416	29,019
Platteville	1,901	9	159,098	2,307	9,069	11,376	9,641	11,948
Pueblo	100,941	667	16,753,164	242,921	954,930	1,197,851	1,015,242	1,258,163
Rangely	2,514	38	1,098,058	15,922	62,589	78,511	66,542	82,464
Silverthorne	1,477	25	500,000	7,250	28,500	35,750	30,300	37,550
Snowmass Village	1,292	33	1,352,743	19,615	77,106	96,721	81,976	101,591
Vail	4,031	160	4,174,075	60,524	237,922	298,446	252,949	313,473
Wellington	1,504	5	100,000	1,450	5,700	7,150	6,060	7,510
Westminster	59,898	498	14,409,723	208,941	821,354	1,030,295	873,229	1,082,170
Wray	2,247	29	462,101	6,700	26,340	33,040	28,003	34,704
TOTAL	880,990	8,558	172,377,251	2,499,470	9,825,503	12,324,973	10,446,061	12,945,532

Sources: 1986 CML Salary and Fringe Benefit surveys

* Estimated total salaries for each city obtained from 1985 supplemental statements prepared by Colorado municipalities and submitted to the Federal Bureau of the Census. Where this information was not available, total salaries was estimated by multiplying number of full-time employees by an "estimated average" annual salary of $20,000.

Cities/towns without FICA	Pop.	Full-time empl.	Est. sal. w/o police & fire *	1987 Est. Medicare cost (salaries x 1.45%)	1987 Est. Soc. Sec. cost (salaries x 5.7%)	1987 Estimated Total cost	1988 Est. Soc. Sec. cost (salaries x 6.06%)	1988 Estimated Total cost
Alamosa	6,985	72	1,040,000	15,080	59,280	74,360	63,024	78,104
Arvada	89,032	457	5,940,000	86,130	338,580	424,710	359,964	446,094
Avon	1,130	28	480,381	6,966	27,382	34,347	29,111	36,077
Bayfield	872	6	80,000	1,160	4,560	5,720	4,848	6,008
Boulder	79,738	761	16,362,606	237,258	932,669	1,169,926	991,574	1,228,832
Brighton	13,845	103	1,360,000	19,720	77,520	97,240	82,416	102,136
Cheyenne Wells	1,146	4	40,000	580	2,280	2,860	2,424	3,004
Collbran	366	4	40,000	580	2,280	2,860	2,424	3,004
Colorado Springs	251,091	3,476	16,742,095	242,760	954,299	1,197,060	1,014,571	1,257,331
Craig	9,320	83	1,349,111	19,562	76,899	96,461	81,756	101,318
Crawford	255	2	20,000	290	1,140	1,430	1,212	1,502
Crested Butte	940	15	240,000	3,480	13,680	17,160	14,544	18,024
Durango	12,633	160	2,795,779	40,539	159,359	199,898	169,424	209,963
Fort Morgan	8,934	115	1,700,000	24,650	96,900	121,550	103,020	127,670
Lafayette	12,407	92	1,419,871	20,588	80,933	101,521	86,044	106,632
Lakewood	120,001	639	9,773,551	141,716	557,092	698,809	592,277	733,994
Lamar	8,500	165	2,177,007	31,567	124,089	155,656	131,927	163,493
Las Animas	2,718	36	391,497	5,677	22,315	27,992	23,725	29,401
Longmont	49,050	588	8,940,000	129,630	509,580	639,210	541,764	671,394
Manitou Springs	5,039	50	642,653	9,318	36,631	45,950	38,945	48,263
Mt. Crested Butte	316	12	180,000	2,610	10,260	12,870	10,908	13,518
Northglenn	30,421	210	3,666,025	53,157	208,963	262,121	222,161	275,318
Parker	454	16	125,359	1,818	7,145	8,963	7,597	9,414
Platteville	1,901	9	89,774	1,302	5,117	6,419	5,440	6,742
Pueblo	100,941	667	8,171,637	118,489	465,783	584,272	495,201	613,690
Rangely	2,514	38	816,015	11,832	46,513	58,345	49,451	61,283
Silverthorne	1,477	25	210,439	3,051	11,995	15,046	12,753	15,804
Snowmass Village	1,292	33	1,130,237	16,388	64,424	80,812	68,492	84,881
Vail	4,031	160	2,758,289	39,995	157,222	197,218	167,152	207,148
Wellington	1,504	5	60,000	870	3,420	4,290	3,636	4,506
Westminster	59,898	498	8,276,723	120,012	471,773	591,786	501,569	621,582
Wray	2,247	29	292,790	4,245	16,689	20,934	17,743	21,989
TOTAL	880,998	8,558	97,311,839	1,411,022	5,546,775	6,957,796	5,897,097	7,308,119

*Estimated salaries, not including police and fire department salaries. Information obtained from 1985 supplemental statements prepared by Colorado municipalities and submitted to the Federal Bureau of the Census, where available.

Estimated cost of mandatory medicare and mandatory social security

Total Police/Fire current expenditures in 1984 for all Colorado municipalities of over 2,000 population *	$322,785,100 =	$322.8 million
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1988 MANDATORY MEDICARE PLUS MANDATORY SOCIAL SECURITY	=	$7.3 million

STEVE COWPER
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 3, 1987

The Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
205 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The State of Alaska is very concerned about two of the issues in the President's Budget proposal which are being considered by the Committee. One of the recommendations would extend the Medicare part of the Social Security tax to all state and local employees, and the other proposal would repeal the current exemption from federal excise taxes for gasoline, diesel, and other fuels used by state and local governments.

The State of Alaska, being one of five states which covers its employees' health and pension funds under its own plan, was forced by the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") to extend mandatory Medicare coverage to all its employees who were hired after April 1, 1986. Without reducing benefits to our employees, the State has been able to phase its new hires into the Medicare system. However, if we are expected to bring all our employees under the Medicare system now, rather than through a natural phase-in due to employee turnover, it would cost the State $7 million annually. The proposed change would cost the Municipality of Anchorage $700,000, annually and would impose significant burdens on other cities and towns throughout Alaska.

This change in Medicare coverage could not come at a more inappropriate time for Alaska. Because of the down turn in the price of oil, the State is already being forced drastically to reduce services. In this regard, I have requested that the Alaska Legislature reduce state spending by 27 percent from the level authorized last year. I have asked that municipal assistance and revenue sharing be reduced by 20 percent, and I have also sought the imposition of a state income tax.

It has been estimated that Medicare coverage would cost the average government employee earning $23,000 a year an additional $333.50 in new taxes. In Alaska, where the cost of living is high, most state and local government employees earn more than $23,000. The added Medicare cost would probably eliminate any tax advantage that these government employees will receive under the Tax Reform Act of 1986.

Mandatory Medicare coverage is being proposed as a revenue-raising measure. But, in the long run, the Federal government will be obligating itself to provide coverage to a far greater number of beneficiaries. When the long-term effects are considered, the revenue generated by this provision would be much smaller than suggested by the President. Moreover, the proposal would force expensive and confusing changes in the accounting systems of state and local governments in Alaska, when they are already facing severe financial difficulties.

Another section of the President's budget that is of great concern to the State of Alaska, is the proposal to eliminate state and local government exemptions for Federal highway excise taxes. Such taxes, destroying a basic foundation of Federalism, would be imposed on an integral state function. Further, the user tax on states would be unfair if federal vehicles were not subject to a similar state and local user tax.

I would like to thank the Committee for this opportunity to provide testimony. I hope that this Committee will reject the Medicare proposal, as Congress did last session, and the highway fuel excise tax on states and communities.

Sincerely,

John W. Katz for

Steve Cowper
Governor

cc: Senator Ted Stevens
Senator Frank Murkowski
Congressman Don Young

ecfc **Employers Council on Flexible Compensation**
1660 L Street, NW • Suite 715 • Washington, DC 20036 • (202) 659-4300

STATEMENT OF THE EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION

FOR THE SENATE COMMITTEE ON FINANCE

Employee benefits planning, administration, and communications are in a shambles today. Organizations are spending countless hours and resources developing and installing programs in response to employee needs that are consistent with the latest tax law (usually without the benefit of regulations). Meanwhile, they are studying proposals for the next law, developing legislative positions, and trying to determine for which of the endless number of possible combinations of present law, future law and future future law they should be planning. This is not news to benefits practitioners. Yet, we have been unable thus far to make a significant dent in the comprehension of legislators and regulators that what is going on [illegible] largely counterproductive to the needs of America's workers and employers.

As a result, administration of benefit plans is excessively costly and getting worse. And it is having an adverse effect on the productivity of American companies. Programs and systems must be built up, broken down, and revised with alarming frequency and with productive benefit only to consultants, lawyers and systems designers.

Perhaps, even more importantly, it would appear that the lawmakers are insensitive to the chaotic situation that is created for workers. Employees must struggle with the terms of one program's provisions even while its successor is on the presses. More seriously, they are formulating long range plans and are committing their funds on the basis of one set of rules only to have their plans shattered by another.

Social considerations have been completely ignored as we continue to move ahead without any semblance of a national policy on the position of employee benefits. As policy-forming commissions are endlessly created and dissolved, revenue considerations are becoming the dominant, if not the only, force in tax law formulation. Perhaps this is appropriate. But it should not come to pass that such legislation is enacted without due consideration of the philosophical basis for preferential tax treatment of benefit plans.

Plan sponsors and participants are entitled to some degree of stability which transcends immediate financial crises and political expediency, as they develop their programs and plan their futures. Those few in government who continue to champion this should be warmly and vigorously encouraged in their efforts.

by Martin Bael, President, Employers Council on Flexible Compensation, February 13, 1987 ecfc

EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION

The Employers Council on Flexible Compensation is a non-profit membership association committed to the study and promotion of cash-or-deferred arrangements (401(k) plans), cafeteria plans and other elective benefit plans.

ECFC is the national clearinghouse of information on flexible compensation and the only organization which lobbies specifically for flexible benefit plans.

The Council was founded in 1981 by several Fortune 500 companies which pioneered flexible benefit plans. Now, members of ECFC are plan sponsors who are leading the way in the development and refinement of cafeteria and 401(k) plans and the leading actuarial, insurance and accounting firms that design and administer flexible plans.

ecfc **press release**

FOR RELEASE: 6/20/86

CONTACT: Gini Wilderson

(202) 659-4300

Employers Council on Flexible Compensation • 1660 L Street, N.W., Suite 715 • Washington, D.C. 20036

CHANGING LIFESTYLES: NO. 1 REASON FOR FLEXIBLE COMPENSATION

In a recent survey conducted by ECFC, employers listed three main reasons for establishing a flexible compensation program: different worker family and lifestyle characteristics, overall benefit cost containment, and employee involvement/appreciation of benefits.

To support lobbying efforts, ECFC conducted a nationwide survey of its members to determine employee attitudes toward flexible compensation. Thirty-two members responded; most employ over 25,000 workers.

When questioned about their benefit plans, employers said that approximately 65% of employees chose to contribute flexible dollars to the 401(k) plan last year.

The average maximum amount of flexible dollars (or maximum percentage of compensation) that a participant could contribute to a 401(k) plan under the cafeteria plan was 8.3% of salary. The average amount actually contributed in the last full plan year was 5.4%.

Seventy percent of the employers polled currently maintain a flexible compensation arrangement which complies with the requirements of Code Section 125.

Approximately 71% of the employees were eligible to participate in the company plan; only ten percent chose not to participate in the last full plan year.

ECFC SURVEY

CAUSES OF DELAYING BENEFIT CHANGES

JUNE, 1986

Swinehart
Consulting,
Incorporated

INTRODUCTION

On June 25 through 27, trained interviewers, employed by Swinehart Consulting, Inc., conducted a telephone survey of 247 employers who had reported a delay in contemplated employee benefit changes.

All 247 organizations had been represented on the Fortune lists in either 1985 or 1986, or were public or non-profit employers. One hundred eight were Fortune 1000 industrial corporations.

Six of the 247 organizations no longer existed as they did when they had originally reported the delay, and 216 of the remaining 241 organizations responded to this survey. Those 216 organizations have approximately 830,000 employees.

Interviews were conducted under the direction and supervision of trained personnel, and inputting and tabulation of the data were accomplished at Swinehart Consulting, Inc. in Atlanta, Georgia.

Swinehart Consulting, Inc., certifies the interview and input process to be within academically acceptable tolerances.

The accuracy of this report is based on an expected sample error of +/- 5 %.

25 BENNETT STREET N.W. • ATLANTA, GEORGIA 30309
(404) 355-7614

ECFC EMPLOYEE BENEFITS CHANGE SURVEY RESULTS

During 1985 and early 1986, a number of employers, including your organization, report that they were delaying contemplated employee benefit changes.

1. What one reason can you cite as the primary cause of delaying changes in your company's employee benefits program?

   a. Uncertainty over tax changes
   b. Cost related delays
   c. Administration, legal or systems problems
   d. Labor union opposition (or potential opposition)
   e. Potential employee relations problems
   f. Changes in business conditions (merger, negative financial results, etc.)
   g. Changes in personnel in group planning benefit changes
   h. Other
   i. Undecided/Don't know

2. Since the time of the original delay report to ECFC, have you made the contemplated changes, are you still planning to make those changes, or have you decided not to make the changes at all.

   a. Changes have been made
   b. Still planning to make the changes
   c. Abandoned planned changes
   d. Undecided/Don't know

07-09-86

SWINEHART CONSULTING, INCORPORATED
ECFC - Cause of Delaying Benefit Changes

Question 1 : Reason for delaying benefit changes

1 : Tax change uncertain
2 : Cost related delays
3 : Admin/legal/systems
4 : Labor union oppose
5 : Employee relations
6 : Business conditions
7 : Change in personnel
8 : Other
9 : Undecided/don't know

Question 2 : Status of planned changes

1 : Changes made
2 : Still plan changes
3 : Abandoned changes
4 : Undecided/don't know

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Q002. Status of planned changes	2

07-09-86

SWINEHART CONSULTING, INCORPORATED
ECFC - Cause of Delaying Benefit Changes

Q001. Reason for delaying benefit changes

			ACCUMULATED	
	FREQUENCY	PERCENTAGE	FREQUENCY	PERCENTAGE
Tax change uncertain	64	29.630	64	29.630
Cost related delays	42	19.444	106	49.074
Admin/legal/systems	25	11.574	131	60.648
Labor union oppose	19	8.796	150	69.444
Employee relations	15	6.944	165	76.389
Business conditions	13	6.019	178	82.407
Change in personnel	12	5.556	190	87.963
Other	16	7.407	206	95.370
Undecided/don't know	10	4.630	216	100.000

Q002. Status of planned changes

			ACCUMULATED	
	FREQUENCY	PERCENTAGE	FREQUENCY	PERCENTAGE
Changes made	37	17.130	37	17.130
Still plan changes	81	37.500	118	54.630
Abandoned changes	29	13.426	147	68.056
Undecided/don't know	69	31.944	216	100.000

STATEMENT OF

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

AND

AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
ARKANSAS ROYALTY MEMBERSHIP
CALIFORNIA INDEPENDENT PRODUCERS ASSOCIATION
COASTAL OIL AND GAS ASSOCIATION
EASTERN KANSAS OIL AND GAS ASSOCIATION, INC.
EAST TEXAS PRODUCERS AND ROYALTY OWNERS ASSOCIATION
ENERGY CONSUMERS AND PRODUCERS ASSOCIATION
GEORGIA OIL AND GAS ASSOCIATION
ILLINOIS OIL AND GAS ASSOCIATION
INDEPENDENT OIL AND GAS ASSOCIATION OF NEW YORK
INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA
INDEPENDENT OIL PRODUCERS TRI-STATE, INC.
INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES
INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO
INDIANA OIL AND GAS ASSOCIATION
KENTUCKY OIL AND GAS ASSOCIATION
LIAISON COMMITTEE OF COOPERATING OIL AND GAS ASSOCIATIONS
LOUISIANA LANDOWNERS ASSOCIATION INC.
LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS
MICHIGAN OIL AND GAS ASSOCIATION
NATIONAL STRIPPER WELL ASSOCIATION
NEW YORK STATE OIL PRODUCERS ASSOCIATION
NORTH TEXAS OIL AND GAS ASSOCIATION
OHIO OIL AND GAS ASSOCIATION
OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION
ORANGE COUNTY PETROLEUM ASSOCIATION
PANHANDLE PRODUCERS AND ROYALTY OWNERS ASSOCIATION
PENNSYLVANIA GRADE CRUDE OIL ASSOCIATION
PENNSYLVANIA OIL AND GAS ASSOCIATION
PERMIAN BASIN PETROLEUM ASSOCIATION
ROYALTY OWNERS AND INDEPENDENT OIL AND GAS PRODUCERS ASSOCIATION OF ARKANSAS
TENNESSEE OIL AND GAS ASSOCIATION
VIRGINIA OIL AND GAS ASSOCIATION
WEST CENTRAL TEXAS OIL AND GAS ASSOCIATION

TO

SENATE FINANCE COMMITTEE
HEARING ON

ADMINISTRATION TAX PROPOSALS

FEBRUARY 13, 1987

PROPOSAL TO REPEAL THE WINDFALL PROFIT TAX

The Reagan administration's fiscal year 1988 budget proposal includes a provision to repeal the Windfall Profit Tax (WPT). IPAA submits that WPT repeal is of vital importance. The Windfall Profit Tax is unfair, unreasonable, and is unlikely to raise much revenue through its scheduled phaseout, beginning in January, 1991. The Joint Committee on Taxation estimates that the repeal will result in no revenue loss to the government through fiscal year 1990.

With the current upturn in oil prices, some in Congress believe that the WPT will soon raise revenues. IPAA submits that this is short-sighted. Let's examine the facts that exist for 1987.

Currently, crude oil is selling for between $16 to $18 per barrel. The base price, which is adjusted quarterly for inflation, for Tier 1, 2, and 3 oil respectively, is $18.93, $22.47, and $28.27. Consequently, the "Windfall Profit" is, in reality, a "Windfall Loss," for all categories of oil. Furthermore, the "Windfall Loss" is even greater when severence tax is considered. Most oil analysts believe that the current upturn in oil prices is temporary and that after the winter season, crude oil prices will drop.

When these facts are considered it is difficult to believe that much more than a trickle of revenue would be raised in 1987 or through the scheduled phaseout of this tax beginning in 1991.

Any revenue realized from this tax is dwarfed by the cost of collecting and accounting for it. From the industry's standpoint, thousands of man hours and millions of dollars go into generating what is now worthless paperwork. Keep in mind, that most oil producers cut back their staffs by as much as 60% in 1986 in order to weather the crash in oil prices. Most cannot afford the personnel to comply with the tax. From the government's standpoint, repealing the tax would save millions of dollars and thousands of man hours, as well.

Finally, repeal of the WPT would be symbolic. It would send a clear message to the industry that our government is moving in the right direction on energy issues. Removal of this disincentive would permit oil producers to use funds now devoted to useless administrative activity for exploring and developing badly needed reserves.

Repeal of the Windfall Profit Tax is not only justified, but it makes overwhelmingly good sense.

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS
AFL-CIO

Statement To The
COMMITTEE ON FINANCE
UNITED STATES SENATE

On
Revenue Increases Proposed in
Administration Budget Proposals

February 4, 1987

The International Association of Fire Fighters (IAFF), representing 170,000 fire fighters nationwide, submits this statement for the record in opposition to the Administration's budget proposal to expand mandatory Medicare coverage to currently uncovered state and local government employees.

The IAFF fully supports efforts aimed at reducing the federal deficit. However, we strongly disagree that this goal ought to be accomplished in part through the imposition of new taxes on public employees.

For years, Congress specifically excluded state and local workers from coverage in the Medicare and Social Security system. As a result, workers and their employers have spent years building sound, financially secure retirement systems, most of which provide health benefits. Imposition of mandatory coverage for current employees will place these plans at risk and jeopardize future benefits. As a result, state and local government employees will be unfairly penalized for the cause of deficit reduction.

The mandatory coverage proposal contradicts an important and frequently stated goal of both Congress and the Reagan Administration: providing tax relief to middle income workers. Implementation of the proposal will require the imposition of a new payroll tax on state and local employees. The amount of this new tax will exceed the tax savings provided under the recently enacted tax reform Act.

In addition, the new payroll would also apply to state and local governments and create a fiscal crisis in local government at a time when the federal government has eliminated the General Revenue Sharing program, enacted drastic cuts in federal block grants and in general shifted many areas of financial responsibility back to local governments. The resulting fiscal crisis will cause cuts in essential public safety services at the local level.

The IAFF is troubled by the deceptive and inaccurate argument advanced by proponents in support of the mandatory coverage proposal--that the proposal is "fair" because a majority of state and local employees receive Medicare benefits having paid little or nothing into the system. The implication of this argument--that state and local employees have been receiving a "free ride" with respect to Medicare benefits--is not only inaccurate but is unfair to public employees and the general public. The IAFF represents 170,000 dedicated fire fighters who risk their lives daily in communities all across the nation. These fire fighters do not receive a "free ride" with respect to any health benefits, including Medicare.

First, state and local employees become eligible for Medicare benefits in precisely the same way every other American becomes eligible--either by working the required minimum number of quarters in private sector employment (in addition to their public sector employment) and/or by qualifying as a result of their spouse's covered employment. Despite their employment in the most hazardous occupation in the world, fire fighters support families on an average income of approximately $18,500 per year. Therefore, many of our members work second, private sector jobs to supplement their income and pay Medicare taxes on that income. In addition, our members are employed for significant periods of time in private sector employment before entering the fire fighting occupation and after retiring and, again, pay Medicare taxes on that income.

Second, to the extent this perceived inequity exists, it was corrected by a provision of the 1985 budget reconciliation bill (COBRA) which mandated Medicare coverage for all state and local government employees hired after March 31, 1986. This provision allows for a gradual transition and all employees will be covered in approximately ten years. It will be a breach of faith with state and local employees and employers to change the rules now, less than a year after enactment of COBRA, and require immediate complete coverage.

This proposal has been thoroughly debated and twice rejected by Congress. The IAFF urges the Committee to abandon this proposal and seek other avenues for generating revenue.

INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA—UAW
OWEN F. BIEBER, PRESIDENT
RAYMOND E. MAJERUS, SECRETARY-TREASURER
VICE-PRESIDENTS
BILL CASSTEVENS • DONALD F. EPHLIN • ODESSA KOMER • MARC STEPP • STEPHEN P. YOKICH

[illegible]
[illegible]
[illegible]
[illegible]

February 13, 1987

Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We wish to comment on two aspects of the Administration's tax proposals: the proposed increase and restructuring of the Pension Benefit Guaranty Corporation premium and the imposition of Social Security taxes on employer-provided group term life insurance.

PBGC Premium

The PBGC premium was most recently raised to $8.50 per covered participant as part of the Single Employer Pension Plan Amendment Act which was incorporated into the Consolidated Omnibus Budget Reconciliation Act. Primarily as a result of recent pension plan terminations in the steel industry, the new premium level is inadequate. We agree that an increase in premiums is required.

We strongly oppose the Administration's "exposure-related premium".

Details of the Administration's proposal have not yet been made available. We understand, however, that the Administration wants PBGC premiums to increase in proportion to increases in unfunded liabilities per participant. These liabilities are largely created when: (1) credit is provided for service for periods prior to the establishment of a plan, or (2) increases are provided in benefit levels for past service in ongoing plans. Provision of credit for past service in these ways is a central feature of a sensible pension program. Public policy should encourage recognition of a worker's total service in private pension plans in order to generate adequate retirement income.

The Administration's proposal, however, would wrongly penalize employers who do recognize a worker's total service, both at the outset of a plan and at subsequent benefit level increases. It would sharply discourage a good practice developed over almost 40 years of private sector pension negotiations and diminish retirement income for millions of workers.

The burden of this new structure would fall particularly hard on pension plans in the industrial sector, a sector of the economy which is already hard hit. It would be especially burdensome for companies already facing serious economic difficulty. In fact, the proposal is punitive to these plans since there is relatively low risk of underfunded plans terminating.

Most of the PBGC's current liabilities are the result of terminations of plans of a very few large, financially-troubled employers. At the same time, since most plans are well-funded, the large increase in premiums for some employers would bring relatively small decreases in premiums for other employers.

The basic problem with a risk-related premium is that it leaves without protection those workers and retirees who need it the most. They would be the unfortunate "uninsurable".

Taxation of Employer Provided Group Term Life Insurance

The UAW is also strongly opposed to the imposition of Social Security taxes or other taxes on employer-provided group term life insurance. Employer-provided group term life insurance along with other employer-provided fringe programs are exempt from payroll taxes because it is desirable to encourage the development and growth of these programs. Congress recently affirmed its position on taxation of employer-provided fringe benefits when it rejected proposals to tax them as part of the tax reform legislation.

It is important to remember that revenue gains to Social Security Trust Funds provide no relief from the serious problem of federal budget deficits in the general operating accounts of the government. Social Security revenues can and should be used only for the payment of benefits and administrative expenses of the program, not to disguise the imbalance between income and expenditures in other functions of government. Finally, the new tax is not needed; the Trustees of the Social Security Program have projected that the OASDI program is actuarially sound for the next 75 years.

We respectfully request that this letter be made a part of your hearing record on the Administration's tax proposals. Thank you for your consideration of the UAW position on these two issues.

Sincerely,

Dick Warden
Legislative Director

DW:car
opeiu494

MAINE SCHOOL ADMINISTRATIVE DISTRICT #5
OFFICE OF THE SUPERINTENDENT
5 GRACE STREET
ROCKLAND, MAINE 04841
596-6620

WILLIAM STERNBERG
Superintendent
GERALD MALCOLM
Assistant Superintendent
DR. ROBERT WILLIAMS
Director/Exceptional Children

February 4, 1987

Mr. William J. Wilkins
Committee on Finance
Room SD-205
Dirksen Senate Office Building
Washington, DC 02510

Dear Mr. Wilkins:

I am writing in opposition to the proposal of a Medicare Tax for all employees.

In our little school district on the Coast of Maine with less than 1800 students, our February 5th payroll amounted to $169,990.87. This figure multiplied at the rate of 1.45% yields a figure of $2,464.88. This figure times the 26 payrolls in a budget year totals a proposed budget requirement of $64,086.88. This figure is based on current salaries not the increased salaries that we certainly will be facing.

Therefore, any support you can give to keeping the Medicare tax at its present level would be greatly appreciated by the taxpayers of this area.

Yours truly,

William L. Sternberg

William L. Sternberg
Superintendent of Schools

WS/sds

Owl's Head Rockland South Thomaston

NAGE SEIU
NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES
AFFILIATED WITH SERVICE EMPLOYEES INTERNATIONAL UNION, AFL/CIO
1313 "L" STREET, N.W., WASHINGTON, D.C. 20005
202/371-6644

STATEMENT OF THE

NATIONAL ASSOCIATION OF GOVERNMENT EMPLOYEES

TO THE

SENATE FINANCE COMMITTEE

ON THE

FY 88 BUDGET PROPOSAL TO EXTEND MANDATORY MEDICARE COVERAGE TO ALL STATE AND LOCAL GOVERNMENT EMPLOYEES

FEBRUARY 13, 1987

The National Association of Government Employees is an affiliate of the Service Employees International Union, the fifth largest union in the AFL-CIO. As a public sector labor organization NAGE represents thousands of state and local government employees across the country. On behalf of our members, NAGE would like to thank the Committee for this opportunity to present our views on the Administration's FY 88 Budget Proposal seeking to extend mandatory medicare coverage to all state and local government employees.

NAGE is vigorously opposed to the Administration's proposal on a number of grounds. Overall, NAGE believes that the Administration's plan constitutes a short sighted and ineffective attempt to address federal budgetary concerns without regard for the drastic consequences for state and local governments, their employees, and the general public. In the long term the Administration's proposal fails as a revenue gaining device, and will cause widespread fiscal chaos and disruption at the state and local level.

Extending mandatory medicare coverage as proposed by the Administration would impose a new, overwhelming, cost burden upon state and local governments. While the Administration estimates that the proposal will increase federal revenue by $1.6 billion in FY 88, state and local governments would be faced with massive fiscal hardship. As currently proposed, the Administration's plan would impose significant payroll cost increases on states and localities. Public employers and their employees alike would be forced to contribute an additional 1.45% of payroll to the Medicare program. An immediate and severe financial impact would be felt by public employers faced with such drastic increases in payroll costs. While increasing payroll costs, enactment of the proposal will also jepordize the status of those state and local government health and benefit plans already in existence. Just as these plans will be placed at risk, so to will the employees relying on them face an uncertain future.

It is already well established that state and local governments are struggling with the effects of recent federal budget cutbacks. The current proposal will result in almost unavoidable increases in local taxes, and/or further reductions in the services that state and local governments are able to provide to their citizens. The requisite service cuts, or tax increases, will be particularly severe in those jurisdictions which mandate a balanced budget.

As dramatic as the impact of this proposal will be on state and local governments, the impact on individual public employees is potentially as devasting. As noted above, existing state and local health plans will be particularly hard hit by the Administration's proposal. If Congress should enact the Administration's proposal a public employee earning $23,000 annually will pay a Medicare tax of $334. For approximately 4.5 million Americans the proposal thus constitutes a tax increase that completely negates the expected benefit of the Tax Reform Act of 1986. Indeed, adoption of the Administration proposal will mean that for the middle class public employee earning $23,000 there will be no tax cut. Instead of the $191 tax cut they had anticipated, these public employees will receive a net tax increase of $143.

As noted earlier, the Administration's proposal is an attempt to raise revenue at the expense of the welfare of state and local governments and their workers. Similiar versions of this proposal have been properly rejected several times in the past. The proposal is merely a short term revenue raising device that does little to improve the current federal budget crisis while greatly aggravating problems at the state and local level. In any event, there is, in reality, no need for this proposal. In the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") , Congress adopted legislation that will gradually extend mandatory medicare coverage. Under "COBRA", all newly hired state and local government employees will be brought under mandatory medicare coverage as they enter the workforce. Eventually, through normal workforce turnover, all state and local government employees will be covered by Medicare. "COBRA"s gradual phase in of new hires into the Medicare Program allows state and local governments to preserve the integrity of their existing health and benefit plans without the fiscal upheaval and disruption that will follow in the wake of the Administration's proposal. Unlike the Adminstration's plan, "COBRA" represents an appropriate compromise between federal and local interests in this matter.

Finally, NAGE finds it curious that this Administration, which has justified its previous massive reductions in grants and aid to the states and localities on the grounds that it promotes the role of the states in the "new federalism", has seen fit in this proposal, to dictate to state and local governments the specific type of medical plan they will provide to their employees. The Administration's hypocritical approach to its theme of "new federalism" is exposed in this proposal. NAGE believes that justice and fair play require that the Administration's proposal be defeated.

Once again, NAGE asks that you reject any proposal that will substitute a short term, ineffective budget fix at the expense of the fiscal integrity of state and local governments, and the honest expectations of their public employees.

National Conference of State Legislatures

444 North Capitol Street, N.W.
Suite 500
Washington, D.C. 20001
202/624-5400

President Irving J. Stolberg
Speaker
House of Representatives
Connecticut

Executive Director
Earl S. Mackey

STATEMENT FOR THE RECORD

HON. KAREN MCCARTHY

STATE REPRESENTATIVE

MISSOURI HOUSE OF REPRESENTATIVES

ON BEHALF OF

THE NATIONAL CONFERENCE OF STATE LEGISLATURES

SUBMITTED TO THE

SENATE COMMITTEE ON FINANCE

REGARDING

REVENUE PROPOSALS IN THE PRESIDENT'S BUDGET

FEBRUARY 13, 1987

Denver Office: 1050 17th Street • Suite 2100 • Denver, Colorado 80265 • 303/623-7800

My name is Karen McCarthy. I am Chair of the Ways and Means Committee of the Missouri House of Representatives and Chair of the Federal Budget and Taxation Committee of the National Conference of State Legislatures.

I would like to submit for the record the position of the National Conference of State Legislatures regarding several of the tax increases proposed in the President's budget. The three items that I have chosen to address are the repeal of the highway excise tax exemption for state and local governments, the immediate extension of Medicare coverage to all state and local employees, and finally, the proposed inclusion of railroad workers within state-federal unemployment insurance programs.

1. Repeal of Exemption from Highway Excise Tax

In its attempt to give the appearance of no new taxes on individuals, while raising revenues to reduce the deficit, the Administration offers a proposal that would impose a direct tax on state and local governments. Calling the excise tax a "user fee" does not make it acceptable. In fact, treating state and local governments as simply commercial enterprises, rather than as full partners in providing services to our shared constituencies, undermines established principles of tax immunity and federalism. This proposal contradicts the commitment to federalism announced by the Administration's Working Group on Federalism. To shift the federal deficit to state and local governments while causing them to increase taxes to maintain the same level of services is, at the least, hypocritical. We serve the same taxpayers.

The expressed intention to include these revenues within the Highway Trust Fund is justifiably met with skepticism by state and local governments. First, if the money from the Trust Fund is all earmarked for expenditure, then there is no net federal revenue gain to contribute to reducing the federal deficit. Second, we have immediate reason to question this recommendation because of the substantial delays in returning the Trust Fund money to the states for urgent transportation needs.

Because of the dubious validity of the stated reasons for imposing this tax on state and local governments, we might conclude that this proposal is actually the start of yet another assault on state and local treasuries. Such a threatening gesture should be categorically rejected by the Congress.

2. Extension of Medicare Coverage to All State and Local Employees

With its proposal for mandatory Medicare coverage for all employees of state and local governments, the Administration violates the agreement to a gradual phase-in of coverage for all newly hired employees on or after April 1, 1986 reached in the Consolidated Omnibus Budget Reconciliation Act of 1985 (CORBA) by the Administration, Congress and the states.

In this attempt to raise revenue for deficit reduction, the Administration will be reneging on its promise of a tax reduction to low and middle income Americans by increasing the Medicare payroll tax on at least 4 to 5 million Americans employed by state and local governments. The immediate Medicare tax on employees would also seriously jeopardize the fiscal integrity of at least the 10 states that currently have the highest percentage of non-covered employees: Alaska, California, Colorado, Illinois, Louisiana, Maine, Massachusetts, Nevada, Ohio and Texas.

In addition, the Administration's revenue estimate does not take into account the diminishing number of state and local employees outside of the Medicare system since COBRA. Nor does the Administration's revenue estimate consider the cost of bringing 4 to 5 million Americans into Medicare as future beneficiaries.

3. Railroad Unemployment Insurance

Finally, the Administration again seeks to merge railroad workers into the state-federal unemployment insurance program. As we have testified in previous years, NCSL would support such a measure if there were a compelling reason to do so. No such evidence exists at this time. Both management and labor of the railroad industry reportedly continue to work within a mutual agreement regarding their unemployment and retirement systems.

If Congress were inclined to sanction a merger for minimal deficit reduction purposes, NCSL would urge that administrative grants for unemployment insurance be increased to accommodate obviously greater workloads; that state trust funds be reimbursed for benefits that result from wages paid prior to any merger; and that states be included in fashioning a gradual transition plan.

I stress the lack of any current need to effectuate a merger and urge you to resist the Administration's recommendations unless convincing evidence of need is forthcoming.

Thank you for your consideration in these matters.

OPPOSE

1300 LOGAN STREET DENVER, CO 80203
Telephone: (303) 832-9550

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Terry L. Lantry
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ORGANIZATIONS
Alaska Public Employees' Association
California Teachers Association
Colorado Association of Public Employees
Colorado Association of School Executives
Colorado Classified School Employees' Association
Colorado Education Association
Colorado Public Employees' Retirement Association
Colorado Retired School Employees' Association
Denver Public School Employees' Pension and Benefit Association
Fire and Police Pension Association of Colorado
Illinois Education Association
Las Vegas Police Protective Association Civil Employees, Inc.
Massachusetts Teachers Association
Nevada Public Employees' Retirement System
Ohio Education Association
Teachers' Retirement System of Illinois
United Teachers-Los Angeles

STATEMENT OF ROBERT J. SCOTT

ON BEHALF OF

ORGANIZATION FOR THE PRESERVATION OF THE PUBLIC EMPLOYEES' RETIREMENT INDUSTRY AND OPPOSITION TO SOCIAL SECURITY EXPANSION TO SUCH INDUSTRY

(OPPOSE)

Before the Senate Committee on Finance

Hearing on Revenue Increases in the President's Budget

February 13, 1987

Before the Senate Committee on Finance

Hearing on the Revenue Increases
in the President's Budget

February 13, 1987

Members of the Senate Committee on Finance, I am Robert J. Scott, secretary-treasurer of OPPOSE. OPPOSE is a Colorado corporation formed by teachers, firefighters, police, and other state and local government employees who have elected not to join the Social Security system. The purpose of our organization is to assure the continued financial integrity of our members' retirement and health insurance plans by resisting congressional efforts to mandate Social Security or Medicare coverage of public employees. Our members are found in Alaska, California, Colorado, Illinois, Massachusetts, Nevada, and Ohio. With respect to the issue of mandatory Medicare coverage, the interests of OPPOSE are identical to those of the four to five million public employees throughout the nation who remain outside the Social Security system.

Through this testimony, we wish to express our strong opposition to the proposal in the Administration's budget to impose Medicare coverage upon all state and local government employees effective January 1, 1988.

By way of background, I would remind you that employees of state and local government were not permitted to join the Social Security system when it was established in 1935. While they have been permitted to join since the 1950s, those who have chosen to remain outside the system have their own retirement plans and, in many instances, health insurance plans.

In response to the federal government's pressing need for revenues, Congress, in the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), determined to require public employers and their employees to pay the Medicare tax. It implemented this decision by extending mandatory Medicare coverage to all state and local government employees hired on or after April 1, 1986. Through adoption of this phase-in provision, which will result in Medicare coverage of all public employees through normal job turnover, Congress assured itself that all public employees will ultimately pay the full Medicare tax to the federal government. The individuals excluded from coverage under COBRA were those who were already working and for whom the Medicare tax would both constitute a pay cut and jeopardize their existing health benefits. While we at CPPERS did not favor mandatory Medicare coverage, we believed that the phase-in provision adopted in COBRA was a reasonable, permanent solution that avoided imposing overwhelming burdens on state and local governments and their employees.

Last year, during consideration of the Omnibus Budget Reconciliation Act of 1986, Congress threatened to abandon COBRA's phase-in by mandating coverage of those employees specifically excluded from coverage under COBRA, but, in the end, did not adopt such a provision.

We believe that the phase-in compromise reached in COBRA should be respected and that our employees and retirees should not be visited by the same threat year in and year out. Therefore, and for the reasons set forth below, CPPERS asks you this year to finally reject the proposal to extend mandatory Medicare coverage to all state and local government employees.

1. Despite the promises of the President not to raise taxes and the avowed intentions of many legislators to provide a tax cut to the middle class, this proposal targets four to five million lower-middle-class Americans and their spouses for a tax increase that would more than offset the tax cut that they will receive as a result of the Tax Reform Act of 1986. According to estimates of the Joint Committee on Taxation, the Tax Reform Act would provide taxpayers with incomes in the range of $20,000 - $30,000 with a cut equivalent on the average to $191. The new Medicare tax that would be imposed upon state and local government employees equals 1.45% of payroll. Thus, in the case of the average government employee in Colorado (whose annual salary is $23,000), the new Medicare tax of $334 would result in a net tax increase of $143. If the Colorado government passes its equivalent new tax along to the employees, the employee's tax increase would double.

2. Mandatory Medicare coverage would impose a heavy fiscal burden upon state and local governments, who are already operating with very limited resources. While the impact of the proposal would fall most heavily upon governments in approximately ten states, almost every state includes some subdivisions with non-covered employees that would be significantly harmed by these additional operating costs. (See attached table.) We would point out that the proposal would cost governments in Texas $126 million annually; governments in

California, $282 million; governments in Colorado, $48 million; governments in Michigan, $16 million; and governments in Maine, $15 million.

Imposition of these additional costs would come at a particularly trying time. State and local governments have repeatedly been forced to shoulder additional burdens in recent years, resulting from considerable cuts in the federal appropriations for many of their programs and the loss of revenue-sharing, while the Tax Reform Act limited their ability to raise revenues, through loss of the sales tax deduction and new restrictions upon municipal bonds. This trend is continuing; the Administration's budget for fiscal 1988 includes $3.3 billion in further grant-in-aid outlays, including reductions in Medicaid outlays, reductions for mass transit programs, termination of urban development action grants and economic development assistance, and a phased-in termination of the community services block grant.

As a result, state and local governments (many of which operate under balanced budget restrictions) are simply unable to absorb additional fiscal burdens. Many local governments must already raise taxes to maintain existing public service spending levels formerly funded through revenue-sharing. A recent study by the National League of Cities concluded that for more than half of the cities and towns throughout the United States, general fund expenditures would exceed annual revenues in fiscal 1986. The National Conference of State Legislatures has reported that total state fund balances declined by nearly 40% during fiscal 1986.

The states that reported deficits at the end of fiscal 1985 -- Alaska, Louisiana, and Texas -- are among the states with the highest percentage of non-covered employees, and thus would be most harshly affected by the proposal. For Texas, which faces declining oil revenues and record-high unemployment, a tax increase of $126 million for state and local governments might well be disastrous.

3. Mandatory Medicare coverage would have a pointedly adverse impact upon education. It is well recognized that one of the causes of the current state of our public education system is the extreme difficulty school systems face in recruiting quality teachers. It has been reported that half of the nation's public school teachers will cease to teach over the next six years and that the country will have 34% fewer teachers than it needs by 1992.

One reason for this problem is that teachers are vastly underpaid. In 1985-1986 the average teacher's salary was

$25,000, while the averages ranged state-by-state between $18,000 and $41,000. In constant dollars, the average American schoolteacher's salary has risen only 2.87% over the last ten years. The constant-dollar increase has been even less in several of the states that would be most heavily affected by mandatory coverage. In four of those states (California, Illinois, Louisiana, and Maine) the average teacher's salary has actually declined in constant-dollar terms.

Medicare coverage would only make the teacher recruitment problem worse. Teaching is one of the major professions with large numbers of non-covered employees. The 1.45 percent Medicare tax would take an additional $367 from the average teacher's salary each year. That amount could double if school systems attempt to recoup their own, equal Medicare tax obligations from their employees. Thus, it would become even more difficult to recruit and retain good teachers, and many of the most qualified teachers -- particularly those with marketable skills in mathematics, science, and computers -- would simply leave teaching for better paid employment.

4. The mandatory Medicare coverage proposal would create a host of problems that were avoided by the compromise position adopted in COBRA. As mentioned earlier, some state and local government employees have health plans in place for their employees, including retirees. Adjustment of these plans to take account of Medicare coverage for existing employees would prove an overwhelming task, or would result in abandonment of these plans. For example, Colorado's Public Employees' Retirement Association administers a health insurance plan for its members. Of the overall retirement contribution, 0.8 percent is earmarked for the health insurance fund. If the current mandatory Medicare coverage proposal were adopted, the Colorado legislature (which is already operating under strict budgetary constraints) could well decide to contribute less or none at all to the health insurance plan. Because the benefits of current retirees depend upon current and future contributions, their benefits would certainly be jeopardized. Moreover, as a result of this increased Medicare tax liability, the Colorado legislature might well decide it could not afford cost-of-living adjustments to the retirement benefits of its pensioners.

Unlike COBRA, the current proposal would have the effect of reducing the salary of existing workers, including long-term employees. This will cause difficulties both for employers and employees, particularly where salaries are carefully negotiated, for example, through the collective barganing process.

While COBRA affects the health benefits and take-home pay of individuals at the time they begin employment, the effect of the current proposal would be to supplant benefit programs that individuals have enjoyed, in some cases, for many years, and to reduce the amount of take-home pay they have come to expect.

5. The projected revenues for mandatory Medicare coverage are overstated in the Administration's budget. The budget includes an estimate that its mandatory Medicare coverage proposal would raise $1.6 billion in fiscal 1988 and $2.2 billion in each of the four following years. Since these estimates do not decline in the out-years, they apparently ignore the effect of the provision in COBRA that imposed mandatory Medicare coverage on all newly hired public employees. As result of that provision, the proportion of Medicare-covered employees in the public work force is increasing rapidly. In Colorado, which we believe to be a typical example, state and local government work forces turn over at a rate of approximately 9% annually. Thus 9% of the work force not covered before COBRA will already be covered by Medicare on April 1, 1987, and approximately 15% will be covered by January 1, 1988, the effective date of the current mandatory coverage proposal.

Revenues raised by coverage of these new employees have already been obtained by Congress in COBRA and presumably scored for budget purposes. Even if there is some job "turnover within the turnover" as new employees replace those hired after April 1, 1986, the revenues available in the the out-years must decline substantially, and ultimately decline to zero, as a result of the complete turnover of the work force. At best, the current mandatory Medicare coverage proposal would provide only "quick fix" deficit reduction and would do nothing to reduce the structural deficit.

Moreover, expansion of mandatory Medicare coverage would also entail offsetting costs to the Medicare system because the newly covered individuals will also become newly entitled to benefits. Some of these cost increases would occur in the very near term because if Congress extends the Medicare tax to all state and local government employees, it will probably provide benefits to those workers who are within five years of retirement (as it did for federal workers when it brought them into the system). While it is frequently asserted that requiring state and local government employees to participate in the Medicare system would be cost-free because the employees already receive Medicare benefits through other covered employment or through their spouses, the number of such employees has been the subject of some dispute and speculation. As a result, the additional costs to the federal government, which must be offset against revenues, may be understated. Given the short-run deficit that now faces the Medicare system, a proposal that involves potential and unpredictable short-term cost increases to the system seems poor policy. Of course, because it spans only five years, the revenue estimates in the President's budget fails to reflect any of the long-term costs to the system resulting from the fact that a new class of workers would become entitled to benefits.

* * * * * *

For these reasons, we urge you once again and finally to reject the proposal to extend mandatory Medicare coverage to include all state and local government workers. Thank you for allowing me this opportunity to present the views of OPPOSE.

3663T

ANNUAL COST TO STATE AND LOCAL GOVERNMENTS OF MEDICARE COVERAGE OF ALL EMPLOYEES
(in millions of dollars) [a]

State	Number of Employees Who Do Not Participate in the Medicare/Social Security System [b]	Cost of Coverage of all state and local employees [c]
Alabama	0	0
Alaska	19,000	6.3
Arizona	24,000	8.0
Arkansas	6,000	2.0
California	848,000	282.0
Colorado	143,000	47.7
Connecticut	72,000	24.0
Delaware	12,000	4.0
Florida	79,000	26.3
Georgia	84,000	28.0
Hawaii	16,000	5.3
Idaho	2,000	.7
Illinois	395,000	131.7
Indiana	39,000	13.0
Iowa	7,000	2.3
Kansas	17,000	5.7
Kentucky	61,000	20.3
Louisiana	210,000	70.0
Maine	46,000	15.3
Maryland	21,000	7.0
Massachusetts	339,000	113.1
Michigan	48,000	16.0
Minnesota	87,000	29.0
Mississippi	0	0
Missouri	66,000	22.0
Montana	8,000	5.1
Nebraska	8,000	2.7
Nevada	44,000	14.7
New Hampshire	5,000	1.7
New Jersey	0	0
New Mexico	20,000	6.7
New York	72,000	24.0
North Carolina	30,000	10.0
North Dakota	13,000	4.3
Ohio	602,000	200.8
Oklahoma	29,000	9.7
Oregon	17,000	5.7
Pennsylvania	20,000	6.7
Rhode Island	13,000	4.3
South Carolina	8,000	2.7
South Dakota	6,000	2.0
Tennessee	36,000	12.0
Texas	377,000	125.7
Utah	10,000	3.3
Vermont	2,000	.7
Virginia	0	0
Washington	4,000	1.3
West Virginia	8,000	2.7
Wisconsin	54,000	18.0
Wyoming	8,000	2.7
TOTAL	4,037,000	1,347.2

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[a] These figures reflect only the 1.45% that must be paid by the governments as employers, and do not include the cost increases to their employees, who must also begin to pay the 1.45% Medicare tax.

[b] Social Security Administration, Office of Research, Statistics, and International Policy, Research and Statistics Note Report No. 5 (December 7, 1983) (setting forth 1980 statistics). Although the U.S. Bureau of the Census, in the 1982 Census of Governments, has published different and slightly more recent statistics (for 1981), we have used the Social Security Administration's statistics because they are more conservative. Presumably included in these estimates are jobs now filled by employees hired after March 31, 1986, who participate in the Medicare system as a result of the Consolidated Omnibus Reconciliation Act of 1985, Pub. L. 99-272. These figures might therefore be reduced marginally to account for employee turnover (estimated to occur at a rate of approximately 9% annually) since March 31, 1986.

[c] Given that the employer's part of the 1987 Medicare tax is 1.45%, and assuming that the salary of the average state or local government employee is $23,000, each governmental employer's cost is equal to the number of employees multiplied by 23,000 multiplied by 1.45%.

PMAA
PETROLEUM MARKETERS ASSOCIATION OF AMERICA
1120 VERMONT AVE., NW • SUITE 1130 • WASHINGTON, DC 20005 • (202) 331-1198

February 10, 1987

The Honorable Lloyd Bentsen, Chairman
Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Petroleum Marketers Association of America is a federation of 41 state and regional associations representing approximately 11,000 small independent petroleum product marketers. Collectively these marketers sell over half the gasoline, sixty percent of the diesel fuel and three-quarters of the home heating oil consumed in the country. PMAA is the largest association in the country representing independent petroleum marketers.

PMAA is very interested in three of the tax proposals (numbered 5, 8, and 13 in your January 15 press release) included in the President's FY 1988 budget and appreciates the opportunity to make the following observations on these proposals, with the request that they be included as part of the February 4 Finance Committee hearing record.

The first proposal is the repeal of certain exemptions from federal excise taxes on gasoline, diesel fuel and on certain highway uses. Historically, the President has proposed that the six cents per gallon exemption for gasohol be eliminated. In this budget he also recommends elimination of other exemptions including those provided for local school districts, state and local governments. While PMAA has no position on elimination of the exemptions for other users, we strongly support the termination of the gasohol exemption.

The original purposes of the gasohol exemption were to provide assistance to a struggling ethanol industry, to help U.S. corn and grain farmers by providing another market for their crops, and to lessen U.S. dependence on foreign sources of oil. All of these are noble goals which PMAA initially supported.

However, this tax subsidy has had the unintended effect of making gasohol cheaper than gasoline, thus giving gasohol marketers a strong competitive advantage in many markets. PMAA believes this is inconsistent with the original intent of Congress, which was to make gasohol competitive, but not cheaper than gasoline.

In addition, studies have shown that this subsidy, which costs the federal government an estimated $300 - $500 million per year, has had only nominal impact on corn and grain prices. Most of the subsidy appears to have found its way into the pockets of a few large ethanol producers.

Even had the subsidy achieved its original purposes, it would still be time to eliminate it. With the growth of the federal deficit and the hard choices being made to reduce it, it is inappropriate for the federal government to continue subsidizing the ethanol fuels industry.

Formerly National Oil Jobbers Council

Moreover, the level of the subsidy can be expected to grow substantially in the future as a result of a change in the gasoline excise tax collection procedure enacted as part of the Tax Reform Act of 1986. Under this new procedure, which allows the gasohol exemption "up front" only if you buy gasoline and ethanol from the same supplier at the same terminal, many refiners and many marketers that have disdained gasohol up to now, will, for competitive reasons, be forced to become actively involved in gasohol sales.

As a result of this revision, refiners to remain competitive will now be forced to offer preblended gasohol to their customers. Marketers will buy more gasohol in order to avail themselves of its more favorable tax status vis-a-vis gasoline. As one ethanol producer told PMAA, "This tax change is going to be a big marketing aid for my company." It is highly likely that this mass move to gasohol will drain substantial revenues from the Highway Trust Fund.

The second area of the President's budget on which PMAA would like to comment involves increases in funding for the Internal Revenue Service. While PMAA is not endorsing the specific areas of increased funding being proposed, PMAA does recognize and support the need for greater IRS funding in the areas of excise tax collection enforcement. The abysmal record of the IRS in connection with motor fuel excise tax enforcement can be documented by a number of public revelations of high level excise tax evasion in recent months.

While changes in the Tax Reform Act were designed to make the Service's enforcement job easier, it will still be virtually impossible to track evasion unless the excise tax accounting system is converted from a manual to a computer system. If this were done, IRS could basically perform excise tax evasion audits in the regional offices. It would also open the door for further modifications in the excise tax collection process to eliminate the competitive advantage refiners and terminal operators will have over individual marketers under the new system.

Federal Highway Administration officials have informally indicated their belief that it would be a legitimate highway trust fund expenditure to help fund IRS's enforcement activity in this area. PMAA supports that view and would urge that the Finance Committee approve such a method of funding.

The final issue on which PMAA wishes to comment concerns the President's proposal to eliminate the Windfall Profits Tax. PMAA supports wholeheartedly this recommendation.

A misnomer from its inception, the Windfall Profits Tax has no place in an industry premised on market economics. The oil industry should not be subjected to a contradictory government policy which says consumers are to receive the full benefit of oil prices as they fall, but if prices rise again, oil company profits will be taxed away. Moreover, even when prices are below the "windfall level," many companies incur substantial administrative costs in completing the paperwork requirement of the IRS.

In conclusion, PMAA supports the Administration's efforts to eliminate the excise tax exemption for gasohol, increased funding for IRS to enforce the gasoline excise tax collection process, and the repeal of the Windfall Profits Tax.

We appreciate your consideration of these views, and if you have any questions, please call.

Sincerely,

Phillip R. Chisholm

Phillip R. Chisholm
Executive Vice President

PRC:cp

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25th Annual RIMS Conference
Las Vegas • March 29-April 3, 1987

TESTIMONY OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

SUBMITTED BY

HOWARD W. GREENE

ASSOCIATE LEGISLATIVE DIRECTOR

RIMS

TO

THE U.S. SENATE COMMITTEE ON FINANCE, FOR ITS HEARING ON REVENUE INCREASES PROPOSED IN THE PRESIDENT'S BUDGET, HELD ON FEBRUARY 4, 1987, 10:00 A.M. IN SD-215 DIRKSEN SENATE OFFICE BUILDING.

205 East 42nd Street, New York, N.Y. 10017 • (212) 286-9292
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THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. REQUESTS THIS STATEMENT BE PLACED IN THE WRITTEN RECORD OF THE UNITED STATES SENATE COMMITTEE ON FINANCE HEARING ON REVENUE INCREASES PROPOSED IN THE PRESIDENT'S BUDGET, HELD ON FEBRUARY 4, 1987 AT 10:00 A.M. IN ROOM SD-215 OF THE DIRKSEN SENATE OFFICE BUILDING. THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS) IS A PROFESSIONAL TRADE ASSOCIATION REPRESENTING MORE THAN 3,900 CORPORATE, GOVERNMENTAL, AND INSTITUTIONAL MEMBERS, INCLUDING 90% OF THE FORTUNE 500 COMPANIES. RIMS IS ACTIVE IN CORPORATE INSURANCE AND EMPLOYEE BENEFIT ISSUES.

RIMS IS CONCERNED WITH THE INCREASING BURDEN BEING UNDERTAKEN BY THE PENSION BENEFIT GUARANTY CORPORATION (PBGC) AND ITS REPERCUSSIONS FOR PBGC PREMIUMS. IT IS WELL KNOWN THAT EVENTS SUCH AS THE LTV CORPORATION PENSION PLANS TERMINATIONS LEAVE THE CURRENT FLAT-RATE PREMIUM OF $8.50 NO LONGER VIABLE. THE PROSPECT OF MORE "LTV'S" MAKES SERIOUS CONSIDERATION OF THIS PROBLEM ALL THE MORE IMPERATIVE.

THE PBGC IS WELL AWARE OF THIS SITUATION. CONSEQUENTLY, THEY HAVE STUDIED THE PROBLEM AND HAVE OFFERED A PROPOSAL TO DEAL WITH IT: VARIABLE-RATE PREMIUMS. UNDER THE PBGC PROPOSAL, A GRADUATED SCALE WOULD BE USED TO CHARGE EMPLOYERS PREMIUMS IN DIRECT RELATION TO THE FUNDING LEVEL OF THEIR PLANS. THE SCALE WOULD HAVE MULTIPLE TIERS.

IF FLAT-RATE PREMIUMS ARE RETAINED, THERE IS LITTLE DOUBT THAT PREMIUMS WILL RISE AT LEAST ANOTHER 100% ABOVE THE PRESENT $8.50 FIGURE. THE PBGC ESTIMATES AN IMMEDIATE JUMP OF ALMOST 200%, WITH A PREMIUM IN THE $25.00 RANGE. THAT ESTIMATE IS ONLY VALID TO MEET PRESENT PBGC LIABILITIES. WITH

THE LIKELIHOOD OF MORE PLAN TERMINATIONS LOOMING OMINOUSLY ON THE HORIZON, PREMIUMS OF $40.00 OR $50.00 IN THE NEAR FUTURE ARE ALREADY BEING FORECAST.

SHOULD THIS SCENARIO BECOME REALITY, RIMS FEARS THE BELL WILL TOLL ON DEFINED BENEFIT PLANS AS A VIABLE PENSION PLAN OPTION. ALREADY MORE BURDENSOME AND COSTLY THAN THEIR DEFINED CONTRIBUTION COUNTERPARTS, DEFINED BENEFIT PLANS MAY BE PUSHED TO THE POINT WHERE COST DETERS EMPLOYERS FROM OFFERING THEM. IRONICALLY, IT WILL BE THE BEST FUNDED PLANS, MAINTAINED BY SOME OF THE MOST RESPONSIBLE EMPLOYERS, WHICH WILL BE CHASED FROM THE SYSTEM. THESE ARE THE SOLID PLANS WHICH THE PBGC IS MEANT TO FOSTER, NOT DISCOURAGE.

A VARIABLE-RATE PREMIUM WILL HELP ALLEVIATE THIS PROBLEM AND PROMOTE EQUITY. UNDER THE PRESENT SYSTEM, WELL-FUNDED PLANS PROVIDE A LARGE SUBSIDY TO UNDERFUNDED PLANS. SUCH A SYSTEM PUNISHES THE FORMER WHILE PROVIDING A WINDFALL FOR THE LATTER; NOT WHAT THE SYSTEM DESIRES, BUT A STARK REALITY NEVERTHELESS.

SWITCHING TO A VARIABLE-RATE WILL END OR DRASTICALLY REDUCE THE UNFAIR SUBSIDY-BASED SCHEME. FURTHERMORE, INSURANCE IS BASED ON PAYING IN RELATION TO RISK AND SINCE THE PBGC PROVIDES INSURANCE, IT MAKES SENSE TO CONFORM PBGC PREMIUMS TO ESTABLISHED PRACTICES.

RIMS URGES THAT THE LOWEST PREMIUM UNDER A VARIABLE-RATE CONFIGURATION BE KEPT TO A MINIMUM, PREFERABLY NO HIGHER THAN THE PRESENT $8.50. GAPS IN ADEQUATE PBGC FUNDING SHOULD BE MADE UP AT THE HIGHER END OF THE PREMIUM

SPECTRUM, WHICH WILL CONSIST OF THE EMPLOYERS WHO MAKE INCREASED FUNDING NECESSARY. THE COMPANIES TO WHICH THE LOWEST RATE WILL APPLY HAVE ALREADY SUFFERED MORE THAN A THREE-FOLD PREMIUM INCREASE IN THE PAST YEAR, FROM $2.60 TO $8.50. SUBSIDIZATION OF LESS RESPONSIBLE PLANS WILL EXIST EVEN UNDER A VARIABLE-RATE $8.50 PREMIUM. MORE RESPONSIBLE EMPLOYERS WILL CONTINUE TO PROP UP LESS RESPONSIBLE ONES. BUT THE DEGREE OF SUBSIDIZATION WILL BE GREATLY DIMINISHED. A VARIABLE-RATE DOES NOT COMPLETELY REMEDY THE SITUATION, BUT HELPS TO MINIMIZE ITS INEQUITY.

RIMS BELIEVES THAT ALL PLANS WHICH ARE AT LEAST 100% FUNDED SHOULD BE SUBJECT TO THE LOWEST PREMIUM RATE. RIMS VIEWS THE 100% PLATEAU AS THE POINT WHERE A PENSION PLAN IS ACTUARIALLY SOUND. ANY PLAN ASSETS ABOVE THE 100% FIGURE ARE EXCESS AND UNNECESSARY TO MEET THE PLAN'S OBLIGATIONS. IF THE ACTUARIAL PROCESSES BY WHICH FUNDING STATUS IS DETERMINED ARE FLAWED, THEY SHOULD BE DEALT WITH DIRECTLY, NOT THROUGH THE PBGC PREMIUM. IF THE PROCESSES ARE CORRECT, THEY SHOULD BE GIVEN PRACTICAL MEANING BY RECOGNIZING 100% FUNDING AS FULL FUNDING. SUCH PLANS SHOULD THEREFORE BE CLASSIFIED AS LOW RISK AND ENTITLED TO THE LOWEST PREMIUM.

A VARIABLE-RATE PREMIUM WILL PLACE GREAT IMPORTANCE ON PENSION ACCOUNTING STANDARDS. IN ORDER TO FAIRLY AND ACCURATELY DETERMINE A PLAN'S FUNDING STATUS FOR PBGC PREMIUM PURPOSES, ONE UNIFORM SET OF ACCOUNTING GUIDELINES SHOULD BE APPLIED. THE FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) HAS PROVIDED THE LOGICAL CHOICE IN ITS STATEMENT NO. 87, EMPLOYERS' ACCOUNTING FOR PENSIONS. EMPLOYERS ALREADY FOLLOW THESE RULES IN PENSION PLAN ACCOUNTING AND FASB IS REGARDED AS THE SOURCE FOR ACCOUNTING GUIDELINES.

Adoption of a variable-rate premium will also serve an important policy function. Under the present flat-rate system, employers wishing to underfund their plans are encouraged to do so. Their premiums will not be affected and should they have difficulty meeting their pension obligations, the PBGC is conveniently ready to remedy the situation.

A variable-rate will discourage such a strategy. Employers wishing to underfund will pay a heavy price in greatly increased premiums. The option will become less attractive.

In the spirit of equity and the recognition of pragmatic concerns, RIMS calls for the adoption of a variable-rate approach to PBGC premiums. It is RIMS' hope that Congress will take action when the Reagan Administration submits its proposal and that such action shall reflect the concerns stated herein.

Thank you.

TAFT, STETTINIUS & HOLLISTER
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[illegible]

February 13, 1987

Mr. William J. Wilkins, Staff Director
  and Chief Counsel
United States Senate Committee on Finance
SD-205 Dirksen Senate Office Building
Washington, D.C.   20510

Dear Mr. Wilkins:

I am enclosing a statement by me on behalf of the [illegible] Import Trade Committee supporting the enactment of the Natural Resource language as a part of any trade bill approved by the Finance Committee and the Senate. It is requested that this statement be included as a part of the record in the continuing hearings on "Mastering the World Economy."

I have indicated in the statement that the language is included in H.R. 3, and it is also included in Senator [illegible] Trade [illegible] and Protection Act of 1987, S. [illegible], which I believe will be referred to the Finance Committee.

Thank you for your attention to this matter.

Sincerely,

Robert Taft, Jr.

RTJr:mw

Enclosure

cc: Edward Stroud
    James D. Williams, Jr.

UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, NORTHWEST
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TELEPHONE (202) 293-7330

THE HONORABLE JOSEPH P. RILEY, JR.
MAYOR OF CHARLESTON, SOUTH CAROLINA

PRESIDENT
UNITED STATES CONFERENCE OF MAYORS

Statement To The

COMMITTEE ON FINANCE
UNITED STATES SENATE

February 4, 1987

I would like to thank the Committee for holding these hearings on the President's proposed revenue increases for the Fiscal Year 1988 budget and for the opportunity provided us to submit our views on the mandatory inclusion of state and local employees under the federal Medicare system. There seems to be no greater issue surrounding American domestic politics at the present time than reducing the federal deficit, with the eventual aim of balancing the budget. It is perhaps the one issue on which we are all agreed: Republicans and Democrats alike; those elected at the national, state and local levels of government all insist that the federal outlay be brought more into line with federal income. With this goal there is no argument among us. Where we may differ is in the manner in which this goal is achieved.

I cannot speak about the President's proposal to mandate the inclusion of state and local employees into the federal Medicare system without putting it in some historical perspective. It seems that every year we are asked "Mr. Mayor, which cut in your programs or revenue enhancement at your expense would you prefer? Which are the most important to you?" I know this hearing was not convened to examine cuts in vital urban programs, but the President's proposal to mandate universal coverage of our employees must not be viewed in a vacuum.

There are several reasons why this proposal is unjust. Briefly, they are :

- It is not a "savings," it is a cost which local governments are not in a position to bear.
- Pre-existing agreements with Congress have assured us this would not occur.
- It is very much a form of increased income tax on individuals -- the very notion both the Congress and the Administration agreed to avoid with passage of the Tax Reform Act of 1986.
- It negates the negotiated agreements between state and local governments and their employees.

I would like to examine each of these points in a bit more detail.

Not a "savings." The Administration estimates that mandatory coverage would increase federal revenues by 1.6 billion dollars in Fiscal Year 1988, and $2.2 billion in each of the next four years. This increase in federal revenues is really a transfer of funds from state and local government and their employees. Mr. Chairman, when key urban programs have been slashed 67 percent since Fiscal Year 1978 in actual dollars and by 80 percent when adjusted for inflation, this is a burden that we at the local level cannot bear.

We have only two major ways to increase our revenues, both regressive: property taxes and, in some states, the sales tax. Unlike Congress, we cannot simply vote to increase our revenues; we must ask our citizens through the ballot box. This sometimes makes it difficult, especially when last year's tax reform act eliminated the federal income tax deduction for state and local sales taxes. But beyond that, state Constitutions place a limit on the amount of tax we are allowed to levy -- and many cities are at that limit. For those of us who could raise taxes, increases in our revenues raised in this manner would fall most heavily on those who are least able to pay.

Pre-existing Agreements. This is not the first time that mandatory coverage of state and local employees has been considered. In 1985 Congress debated this same issue, but finally adopted a reasonable compromise. Under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) a phase-in plan was adopted. By limiting mandatory coverage to employees hired on or after April 1, 1986, Congress allowed for a gradual transition to full coverage. Because state and local governments have approximately a nine percent employee turnover rate, the date for full coverage is not too distant. Yet this phase-in allows us to plan and adjust for this added cost.

Tax Increase. Despite promises from President Reagan and the Congress not to increase income taxes for the middle-class, that is exactly what this proposal would do. If adopted, this proposal would take 1.45 percent of each employees paycheck, with state or local government responsible for an additional 1.45 percent. For a local government employee earning $23,000 annually, the Tax Reform Act passed last year would cut his or her federal taxes by $143. This proposal, however, would add an additional $334 to the amount the federal government takes from his or her paycheck, leaving that employee with a $143 net increase in federal taxes.

Federal Intrusion. By extending coverage to all State and local employees, the proposal would be intruding not only into the existing pay agreements negotiated between state and local governments and their employees, but into their established retirement health plans as well. The COBRA phase-in neatly avoided this problem by applying only to new employees.

Mr. Chairman, the lowering of the federal deficit is a laudable goal -- one that we fully support. We have paid more than our fair share toward the lowering of the federal deficit. Since 1978, vital urban programs have been cut by two-thirds. The fat has been removed from these programs -- what is left is bone. We can give no more.

This year, we are encouraged to hear less talk in the Congress of further reducing or eliminating federal programs to aid our nation's urban areas. However, we are dismayed to see this continued effort to balance the federal budget at the expense of local govenments' budgets, this time through this tax increase. It is surely time to examine tax increases in pursuit of this goal, yet these increases should not be merely a transfer of funds from one level of government to another. The Conference of Mayors looks forward to working with you to find more appropriate sources for revenue increases.

Thank you for the opportunity to express our views.

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